

Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	12
	Forward Looking Information	18
PART II. OTHER INFORMATION		20
Item 1.	Legal Proceedings	
Item 2.	Changes in Securities	
Item 3.	Defaults Upon Senior Securities	
Item 4.	Submission of Matters to a Vote of Security Holders	
Item 5.	Other Information	
Item 6.	Exhibits and Reports on Form 8-K	20

2

PART I: FINANCIAL INFORMATION

Item 1.

SUN HYDRAULICS CORPORATION
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

<TABLE>
<CAPTION>

	SEPTEMBER 30, 1998 (UNAUDITED)	DECEMBER 31, 1997
	<C>	<C>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,474	\$ 1,249
Accounts receivable, net of allowance for doubtful accounts of \$49 and \$47	6,109	4,558
Inventories	7,990	6,775
Other current assets	907	932
	-----	-----
Total current assets	16,480	13,514
Property, plant and equipment, net	42,957	39,789
Other assets (Note 4)	689	86
	-----	-----
Total assets	<u>\$60,126</u>	<u>\$53,389</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 3,758	\$ 2,847
Accrued expenses and other liabilities	2,440	2,174
Long-term debt due within one year	1,744	1,035
Notes payable to related parties due within one year	702	757
Dividends payable	254	221
Income taxes payable	1,136	380
	-----	-----
Total current liabilities	10,034	7,414
Long-term debt due after one year	6,724	6,620
Notes payable to related parties due after one year	649	1,152
Deferred income taxes	3,217	3,203
	-----	-----

Total liabilities	20,624	18,389
	-----	-----
Commitments and contingencies		
Shareholders' equity:		
Preferred stock	-	-
Common stock (Note 3)	6	6
Capital in excess of par value	24,386	24,163
Retained earnings	14,813	10,732
Equity adjustment for foreign currency translation		297
	-----	-----
Total shareholders' equity	39,502	35,000
	-----	-----
Total liabilities and shareholders' equity	\$60,126	\$53,389
	=====	=====

</TABLE>

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

3

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

<TABLE>
<CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30, (UNAUDITED)	
	1998	1997
	----	----
	<C>	<C>
<S> NET SALES	\$17,664	\$17,301
Cost of sales	13,132	11,842
	-----	-----
GROSS PROFIT	4,532	5,459
Selling, engineering and administrative expenses	2,864	3,018
	-----	-----
OPERATING INCOME	1,668	2,441
Interest expense	216	285
Miscellaneous (income) expense (Note 8)	(1,586)	27
	-----	-----
INCOME BEFORE INCOME TAXES		3,038
		2,129
Income tax provision	1,015	777
	-----	-----
NET INCOME	\$ 2,023	\$ 1,352
	=====	=====
BASIC NET INCOME PER COMMON SHARE (NOTE 8)		\$ 0.32
		\$ 0.21
WEIGHTED AVERAGE SHARES OUTSTANDING		6,354
		6,309
DILUTED NET INCOME PER COMMON SHARE (NOTE 8)		\$ 0.31
		\$ 0.21

WEIGHTED AVERAGE SHARES OUTSTANDING	6,560	6,499
-------------------------------------	-------	-------

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

4

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

<TABLE>
<CAPTION>

	NINE MONTHS ENDED SEPTEMBER 30, (UNAUDITED)	
	1998	1997
	----	----
	<C>	<C>
<S> NET SALES	\$54,381	\$47,176
Cost of sales	39,078	32,488
	-----	-----
GROSS PROFIT	15,303	14,688
Selling, engineering and administrative expenses	8,911	8,584
	-----	-----
OPERATING INCOME	6,392	6,104
Interest expense	707	653
Miscellaneous (income) expense (Note 8)	(1,588)	41
	-----	-----
INCOME BEFORE INCOME TAXES	7,273	5,410
Income tax provision	2,430	1,961
	-----	-----
NET INCOME	\$ 4,843	\$ 3,449
	=====	=====
BASIC NET INCOME PER COMMON SHARE (NOTE 8)	\$ 0.76	\$ 0.55
WEIGHTED AVERAGE SHARES OUTSTANDING	6,340	6,303
DILUTED NET INCOME PER COMMON SHARE (NOTE 8)	\$ 0.74	\$ 0.53
WEIGHTED AVERAGE SHARES OUTSTANDING	6,561	6,487

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

5

SUN HYDRAULICS CORPORATION
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(IN THOUSANDS)

<TABLE>
<CAPTION>

<S>	EQUITY ADJUSTMENT						TOTAL
	SHARES	CAPITAL IN COMMON STOCK	EXCESS OF PAR VALUE	RETAINED EARNINGS	FOR FOREIGN CURRENCY TRANSLATION		
<C>	<C>	<C>	<C>	<C>	<C>	<C>	
Balance, December 31, 1996	4,000,002	\$ 2,179	\$ 2,719	\$17,450	\$ 49	\$22,397	
Net proceeds from stock offering	2,300,000	2	19,250		19,252		
Distributions to shareholders			(10,545)		(10,545)		
Dividends declared			(883)		(883)		
Net income			4,710		4,710		
Merger with Sun Holdings (Note 3)		(2,175)	2,123		(52)		
Exercise of stock options	22,000		71		71		
Adjustment for foreign currency translation				50	50		
Balance, December 31, 1997	6,322,002	6	24,163	10,732	99	35,000	
Dividends declared			(762)		(762)		
Net income			4,843		4,843		
Exercise of stock options	38,920		223		223		
Adjustment for foreign currency translation				198	198		
Balance, September 30, 1998 (unaudited)	6,360,922	\$ 6	\$24,386	\$14,813	\$297	\$39,502	

</TABLE>

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

SUN HYDRAULICS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

<TABLE>
<CAPTION>

<S>	NINE MONTHS ENDED	
	1998	1997
<C>	<C>	<C>
Cash flows from operating activities:		
Net income	\$ 4,843	\$ 3,449
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,328	2,784
(Increase) decrease in:		
Accounts receivable	(1,208)	(2,095)
Inventories	(762)	(2,211)
Other current assets	31	534
Other assets	162	1,011
Increase (decrease) in:		
Accounts payable	591	(654)
Accrued expenses and other liabilities	92	545
Income taxes payable, net	770	371
Other liabilities	-	(20)
Net cash provided by operating activities	7,847	3,714
Cash flows from investing activities:		
Investment in Korea Fluid Power (Note 4)	(771)	-

Capital expenditures	(6,017)	(4,889)	
Proceeds from dispositions of equipment		128	40
	-----	-----	
Net cash used in investing activities	(6,660)	(4,849)	
	-----	-----	
Cash flows from financing activities:			
Proceeds from debt	5,882	5,230	
Repayment of debt	(5,977)	(9,857)	
Repayment of notes payable to related parties		(558)	(483)
Proceeds from exercise of stock options	223		71
Net proceeds from stock offering (Note 3)	-		19,252
Cash paid for Sun Holdings merger (Note 3)		-	(52)
Dividends to shareholders	(728)	(662)	
Distributions to shareholders	-	(10,832)	
	-----	-----	
Net cash (used in) provided by financing activities	(1,158)		2,667
	-----	-----	
Adjustment for foreign currency translation		196	(20)
	-----	-----	
Net increase in cash and cash equivalents		225	1,512
Cash and cash equivalents, beginning of period		1,249	1,038
	-----	-----	
Cash and cash equivalents, end of period		\$ 1,474	\$ 2,550
	=====	=====	
Supplemental disclosure of cash flow information:			
Cash paid for:			
Interest (including amounts capitalized)		\$ 737	\$ 901
	=====	=====	
Income taxes	\$ 1,660	\$ 1,590	
	=====	=====	

</TABLE>

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 31, 1997, filed by Sun Hydraulics Corporation (the "Company") with the Securities and Exchange Commission on March 30, 1998.

2. BUSINESS

Sun Hydraulics Corporation, and its wholly-owned subsidiaries, 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"), located in Sarasota, Florida, designs, manufactures and sells through independent distributors in the United States. Sun Hydraulik Holdings Limited ("Sun Holdings"), a wholly-owned subsidiary of the Company, 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, "GmbH"). Sun Ltd. operates a manufacturing and distribution facility located in Coventry, England and GmbH,

located in Erkelenz, Germany, markets the Company's products in German-speaking European markets. Korea Fluid Power Co. Ltd. ("KFP"), a wholly-owned subsidiary of the Company, was acquired September 24, 1998, (see Note 4). KFP, located in Inchon, South Korea, operates a manufacturing and distribution facility.

3. REORGANIZATION AND INITIAL PUBLIC OFFERING

The consolidated financial statements of the Company consist of the financial position and results of operations of Sun Hydraulics, Sun Holdings, and KFP. In January 1997, Sun Hydraulics effected a 9.90372627 for 1 stock split. All prior year share amounts reflected in the financial statements include the effect of the stock split. Additionally, Sun Hydraulics issued 374,811 shares of common stock and made a nominal cash payment of \$52 in exchange for all of the issued and outstanding stock of Sun Holdings (the "Reorganization"). The Reorganization was accounted for in a manner similar to a pooling of interests except for shares held by the minority shareholders which were accounted for at the fair market value of their proportionate share of related assets and liabilities, which approximated book value on the date of the transaction.

8

The Company filed a Registration Statement on Form S-1 with the Securities and Exchange Commission effective January 9, 1997, and issued 2,300,000 shares of common stock in an initial public offering ("IPO"), with an initial offering price of \$9.50. The IPO net proceeds of \$19,252, the exchange of shares with Sun Holdings, and the distribution of previously taxed S Corporation retained earnings are reflected in the statement of changes in shareholders' equity.

The \$19,252 of net proceeds from the IPO were used as follows: an S Corporation distribution of \$9,446, representing 90% of the total distribution of \$10,545 was made, \$7,676 was paid to extinguish debt, \$1,000 was paid to reduce the mortgage on the United States construction loan, and \$1,130 was retained as working capital.

The Company has 20,000,000 authorized shares of common stock, par value \$0.001, with 6,360,922 shares outstanding at September 30, 1998. The Company also has 2,000,000 authorized shares of preferred stock, par value \$0.001, with no shares outstanding.

4. ACQUISITIONS

On September 24, 1998, Sun Hydraulics acquired 100% of the equity shares of Korea Fluid Power Co. Ltd. ("KFP"). This wholly-owned subsidiary will continue Korean operations under the name Korea Fluid Power. KFP had been the Company's exclusive distributor in South Korea since 1988. The acquisition price paid by the Company was \$771, representing \$500 over the net book value of KFP's assets. The Company is currently undergoing an appraisal of the fair market value of KFP's net assets. Values stated in this Form 10-Q are estimates based on historical values, and the Company believes that the appraisal value will not be materially different than the estimates used. Any amounts paid in excess of the appraisal value will be capitalized as goodwill, and will be amortized over a period of 15 years.

5. COMPREHENSIVE INCOME

Effective in the first quarter ended March 31, 1998, the Company adopted SFAS 130, "Reporting Comprehensive Income." SFAS 130 establishes standards for reporting and display of comprehensive income and its components in the Company's consolidated financial statements. Comprehensive income is defined in SFAS 130 as the change in equity (net assets) of a business enterprise during a period resulting from transactions and other events and circumstances from non-owner sources. Total comprehensive income was \$4,975 and \$3,462 for the nine months ended September 30, 1998 and 1997, respectively. The difference between net income as reported and total comprehensive income is the tax effected change in the cumulative foreign currency translation adjustment.

6. RECENT ACCOUNTING PRONOUNCEMENTS

Segment Reporting

In June 1997, the Financial Accounting Standards Board ("FASB") issued SFAS 131, "Disclosure about Segments of an Enterprise and Related Information." Under FAS 131, the basis for determining an enterprise's operating segments is the manner in which management operates the businesses. The statement is effective for fiscal years beginning after December 15, 1997, but does not require compliance with interim reporting requirements until the second year

9

of implementation. The standard addresses disclosure issues and therefore will not affect the Company's financial position or results of operations.

Derivative Instruments And Hedging Activities

The FASB has issued FAS 133, "Accounting for Derivative Instruments and Hedging Activities," which is effective for the Company's fiscal year beginning December 31, 1999. This Statement requires that derivative instruments be recognized as assets or liabilities and measured at fair value. The Company does not anticipate a material effect upon adoption of this standard.

Computer Software Development Costs

In March 1998, the American Institute of Certified Public Accountants issued Statement of Position 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" (SOP 98-1). SOP 98-1 provides guidance for capitalizing and expensing the costs of computer software developed or obtained for internal use. SOP 98-1 is effective for financial statements for fiscal years beginning after December 15, 1998. The Company does not anticipate a material impact on its results of operations from the adoption of SOP 98-1.

7. LONG-TERM DEBT (in thousands)

<TABLE>

<CAPTION>

	SEPTEMBER 30, 1998 (UNAUDITED)	DECEMBER 31, 1997	
<S>	<C>	<C>	
Lines of credit agreements	\$ 958	\$ 666	
Secured notes payable-Korea	824	-	
Mortgage note payable-U.S. manifold facility ("Manatee")		4,895	4,990
Mortgage note payable-German facility		1,791	1,999
	-----	-----	
	8,468	7,655	
Less amounts due within one year		(1,744)	(1,035)
	-----	-----	
	\$ 6,724	\$ 6,620	
	=====	=====	

</TABLE>

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

The United States had a \$1,700 revolving credit agreement, secured by all inventory and accounts receivable, bearing interest at the lender's prime rate with a maturity date of March 1, 1997. In February 1997, the Company negotiated a one-year, unsecured revolving credit facility to replace the \$1,700 revolving credit agreement. This credit facility provided for a maximum availability of \$10,000, payable on demand at the lender's prime rate of interest, and contained

no debt covenants. In February 1998, the Company renegotiated this unsecured credit facility for an additional one year term and 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 September 30, 1998, \$940 was outstanding under this credit facility.

In England, the Company has a \$1,200 line of credit, denominated in British pounds, which bears interest at a floating rate equal to 2.25% over the bank's base rate and is payable on demand. At September 30, 1998 there was no balance outstanding on this credit facility.

The German line of credit is a demand note denominated in German marks with interest payable at the lender's prime rate. At September 30, 1998, \$18 was outstanding under this credit facility.

The newly acquired Korean subsidiary has various secured notes, denominated in Korean Won, and secured by property, plant and equipment, with interest payable at rates ranging from 6% to 15.5% and maturities ranging from December 1998 to March 2005. At September 30, 1998, \$824 was outstanding under these credit facilities.

A 10-year mortgage loan of \$6,187 was obtained at a fixed interest rate of 8.25% for construction of the Manatee 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. The Company applied \$1,000 of the IPO proceeds toward repayment of this note. In March 1998, this mortgage note was renegotiated to an interest rate of 7.875%. Terms are monthly principal and interest payments of \$43 for 8.25 years with remaining principal due July 1, 2006. At September 30, 1998, \$4,895 was outstanding under this credit facility.

In May 1996, the Company obtained a mortgage loan of approximately \$2,400, denominated in German marks, for the new facility in Erkelenz, Germany. The loan has a term of 12 years and bears interest at 6.47%. At September 30, 1998, \$1,791 was outstanding under this credit facility.

8. INSURANCE SETTLEMENT

During the third quarter of 1998, the Company settled a business interruption insurance claim related to a fire that occurred during construction of the Company's facility in Manatee County in August of 1996. The Company received a settlement of \$1,821, or \$1,661 net of expenses. Net income without this settlement, for the three months ended September 30, 1998, would have been \$897. Net income without this settlement, for the nine months ended September 30, 1998, would have been \$3,717.

Item 2.

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

OVERVIEW

The Company 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 through independent distributors.

Orders in the third quarter of 1998, were \$16.7 million, a decrease of \$0.7 million, or 4.0%, from the third quarter of 1997, and a \$0.5 million decrease, or 3.0%, from the second quarter of 1998. The decrease in orders from the second quarter of 1998 was due largely to a general weakening in the European market. Orders for North America and Asia were level with the second quarter of 1998, with a decrease in manifold orders offset by an increase in

cartridge valve orders. The Company has seen a general slowdown in most hydraulic markets around the world and continues to monitor this situation. National Fluid Power Association data indicates that overall hydraulic orders in North America are down 0.5% as of September 30, 1998, compared to December 31, 1997.

Net sales for the third quarter of 1998 were approximately the same as the second quarter of 1998. European and Asian sales leveled off and a continued decrease in United States manifold sales was offset by an increase in United States cartridge valve sales. Weaker United States manifold sales reflect the general economic slowdown in the hydraulics markets. Due to the higher level of earnings contribution typically provided by the manifold products, earnings were negatively impacted by the lower manifold sales volume.

Production of cartridge valves in the United States remained at previous quarter levels despite a redeployment of manifold personnel to the cartridge valve operation. Cartridge valve prime costs increased due to excessive scrap, rework and parts expediting costs. Also, material costs continue to be adversely affected by engineering design changes, supplier price increases and rush procurements. The Company has allocated additional management resources to the United States manufacturing operational area to assist in addressing cartridge valve production activities. At the same time, the Company has assembled a multi-functional team to complete a comprehensive review of procurement processes and suppliers to address the material cost issues.

On September 24, 1998, the Company acquired 100% of the equity shares of Korea Fluid Power Co. Ltd. ("KFP"), for \$0.8 million. KFP had been the Company's exclusive Korean distributor since 1988 and has developed a high level of technical competence with the Company's products. Additionally, for many years KFP has been manufacturing standard and custom manifolds that incorporate the Company's screw-in cartridge valves for sale to the Korean market. With this acquisition, the Company has an established base for designing and manufacturing aluminum manifolds for sale to Pacific Rim markets and has added an experienced and professional management and sales team.

12

In August 1998, the Company settled a business interruption insurance claim related to a fire that occurred during construction of the Company's facility in Manatee County in August 1996. The fire delayed the opening of this facility, which, in turn, delayed the rearrangement of other production processes, adversely affecting the Company's ability to service its customers. The settlement amount of \$1.8 million, or \$1.7 million net of expenses, is recorded as miscellaneous income. Net income for the three months ended September 30, 1998, would have been \$0.9 million without this settlement, or \$0.15 and \$0.14 basic and diluted earnings per share, respectively.

The completion of the move of the equipment for the cellular production of high volume cartridge valves to the Company's Manatee facility, originally planned for the fourth quarter of 1998, has been postponed to the first half of 1999. Additional cellular machinery and equipment is being added, which is expected to increase high volume cartridge valve capacity. To supplement the increased production capacity, a new heat treat facility will be constructed before the end of the fourth quarter of 1999. The heat treat operation will be installed in an addition that will be built at the Company's Manatee facility.

The relocation of high volume cartridge valve production to a separate facility will create space in the Sarasota facility that will increase production capacity for new products as well as the Company's broad range of complementary products, which are produced in smaller quantities. In conjunction with the move of high volume cartridge production to the Manatee facility, plans are underway to construct a slightly smaller, new facility that will house manifold production. The new facility will be located in close proximity to the current Sarasota operations. The Company originally had anticipated the completion of this facility by the end of 1999 but has postponed commencement of construction pending a review of the outlook for the economy.

The Company is in the process of converting its information system for its Sarasota cartridge valve operations. A vendor for the new hardware and

software has been selected and data conversion, testing, and personnel training are well underway. The Company expects to complete this conversion during the first half of 1999. The Company is also completing the implementation of a new information system for its Coventry, England, operation. As with any system conversion, there can be no assurances that the timing of the conversions will be met precisely and that the conversion process will not adversely impact business operating results.

The production of manifolds for prototype and quick delivery requirements, together with some assembly and conversion of cartridges, is scheduled to begin in the German plant during the fourth quarter of 1998. Local production in the German market is expected to provide significantly improved market support and timely product deliveries.

Expansion plans for the production facility in Coventry, England are in process and construction is anticipated to begin in the first quarter of 1999. An additional 12,300 square feet will be added to the Coventry facility on property currently owned by the Company. The additional space will be used to increase further manufacturing and assembly capacity for the Company's products sold in the European market.

13

Sales of the newest addition to the cartridge valve product line, the Series "0" products, have been limited as a result of restrictions on production capacity. The Company will expand its marketing and sales activities for these products as cartridge valve capacity becomes available.

The Company has finalized the design of an electrically actuated cartridge valve product line (solenoid valves), and beta tests are underway at various customer sites. Production is scheduled to begin in the first quarter of 1999.

COMPARISON OF THREE MONTHS ENDED SEPTEMBER 30, 1998 AND 1997

Net sales increased 2.0%, or \$0.4 million, to 17.7 million in the three-month period ended September 30, 1998, compared to \$17.3 million in the three-month period ended September 30, 1997. Domestic net sales increased 3.4%, or \$0.4 million, to \$11.9 million in the three-month period ended September 30, 1998. International net sales decreased 0.5% to \$5.8 million. European net sales increased 6.9%, Canadian net sales decreased 11.4%, and Asian net sales decreased 23.2%.

Gross profit decreased 17.0%, or \$0.9 million, to \$4.5 million in the three-month period ended September 30, 1998, compared to \$5.5 million in the three-month period ended September 30, 1997. This decrease was due primarily to the lower net sales of manifold products in the United States, and a decline of productivity and increased costs of purchased parts in the United States cartridge operation. The cost of subcontracted parts for cartridge valves has been rising steadily due to engineering design changes, quality standard increases and an increase in outsourcing of parts and operations. Gross profit as a percentage of net sales was 25.7% in the three-month period ended September 30, 1998, compared to 31.6% in the three-month period ended September 30, 1997.

Selling, engineering and administrative expenses decreased 5.1%, or \$0.2 million, to \$2.9 million in the three-month period ended September 30, 1998, compared to \$3.0 million in the three-month period ended September 30, 1997. Selling, engineering and administrative expenses as a percentage of net sales decreased to 16.2% from 17.4% for the same quarter last year. This decrease was primarily due to reduced spending in marketing expenses such as trade shows and catalogues, offset by increased spending for support of new business systems in the United Kingdom.

Interest expense was \$0.2 million for the three-month period ended September 30, 1998, compared to \$0.3 million in the three-month period ended September 30, 1997. Miscellaneous income for the three-month period ended September 30, 1998, consisted primarily of the receipt of a business

interruption insurance claim of \$1.8 million, or \$1.7 million net of expenses. (See Note 8)

The provision for income taxes in the three-month period ended September 30, 1998, was 33.4% of pretax income compared to 36.5% of pretax income in the three-month period ended September 30, 1997. This decrease in rate was due primarily to the change in mix of pretax income among the Company's four operating units in Germany, Korea, the United Kingdom and the United States. Additionally, tax savings were realized from the Sun Hydraulics Foreign Sales Corporation in the United States.

14

Net income, excluding the insurance settlement for the three-month period ended September 30, 1998, decreased to \$0.9 million, representing 5.2% of net sales, compared to \$1.4 million, representing 7.8% of net sales for the three-month period ended September 30, 1997. Net income, including the insurance settlement, represented 11.5% of net sales.

COMPARISON OF NINE MONTHS ENDED SEPTEMBER 30, 1998 AND 1997

Net sales increased 15.3%, or \$7.2 million, to \$54.4 million in the nine-month period ended September 30, 1998, compared to \$47.2 million in the nine-month period ended September 30, 1997. Domestic net sales increased 20.3%, or \$6.2 million, to \$36.7 million in the nine-month period ended September 30, 1998. This increase reflected strength in both the mobile and industrial equipment sectors of the fluid power industry and the Company's increased production capacity versus the first half of 1997. International net sales increased 6.1%, or \$1.0 million, to \$17.7 million in the nine-month period ended September 30, 1998. European net sales increased 16.9% and sales to Asia decreased 30.0%.

Gross profit increased 4.2%, or \$0.6 million, to \$15.3 million in the nine-month period ended September 30, 1998, compared to \$14.7 million in the nine-month period ended September 30, 1997. Gross profit as a percentage of net sales was 28.1% in the nine-month period ended September 30, 1998, compared to 31.1% in the nine-month period ended September 30, 1997. The gross profit percentage decrease was due primarily to the increased material costs resulting from product mix, product design improvements, parts expediting and outsourcing.

Selling, engineering and administrative expenses increased 3.8%, or \$0.3 million, to \$8.9 million in the nine-month period ended September 30, 1998, compared to \$8.6 million in the nine-month period ended September 30, 1997. This increase was due to additional personnel and expenses required in the manifold plant in the United States, travel and trade show costs in the United States, and new system implementation costs in the United Kingdom. Selling, engineering and administrative expenses as a percentage of net sales decreased to 16.4% for the nine-months ended September 30, 1998, from 18.2% for the nine-months ended September 30, 1997.

Interest expense was \$0.7 million for the nine-month period ended September 30, 1998, approximately the same as the nine-month period ended September 30, 1997. Miscellaneous income for the period ended September 30, 1998, consisted primarily of the settlement of a business interruption insurance claim in the United States of \$1.8 million, or \$1.7 million net of expenses. (See Note 8)

The provision for income taxes in the nine-month period ended September 30, 1998, was 33.4% of pretax income compared to 36.2% of pretax income in the nine-month period ended September 30, 1997. This decrease in rate was due primarily to the change in mix of pretax income among the Company's four operating units in Germany, Korea, the United Kingdom and the United States. Additionally, tax savings were realized from the Sun Hydraulics Foreign Sales Corporation in the United States.

Net income for the nine-month period ended September 30, 1998, increased to \$4.8 million representing 8.9% of net sales, compared to \$3.4 million, representing 7.3% of net sales for the nine month period ended September 30, 1997. Net income less the settlement of the insurance claim increased to \$3.7 million, representing 6.9% of net sales for the nine month period ended September 30, 1998.

LIQUIDITY AND CAPITAL RESOURCES

Historically, the Company's primary source of capital has been cash generated from operations, although short-term 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.

At September 30, 1998, the Company had working capital of \$6.4 million. Cash flow from operations for the nine months ended September 30, 1998, was \$7.8 million compared to \$3.7 million for the nine months ended September 30, 1997. Approximately, \$1.4 million was due to the increase in net income, \$0.5 million was due to depreciation and approximately \$2.2 was due to a lower percentage increase in working capital. Net cash used in investing activities for the nine months ended September 30, 1998, was \$6.7 million compared to \$4.8 million for the nine months ended September 30, 1997. Approximately, \$0.8 million of the \$1.8 million increase was related to the acquisition of Korea Fluid Power Co. Ltd., and the remainder was due to increased investments in machinery and equipment.

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

In February 1998, the Company renegotiated its one-year, unsecured revolving credit facility in the United States. The credit facility provides for a maximum availability of \$10.0 million, payable on demand and does not contain any debt covenants. The interest rate is 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 September 30, 1998, there was \$0.9 million outstanding under this credit facility.

A 10-year mortgage loan of \$6.2 million was obtained by the Company in May 1996, at a fixed interest rate of 8.25% for construction of the new manifold facility in Sarasota, Florida. Terms on the new mortgage note were interest-only on the balance drawn down through the completion of construction and then conversion to a 10-year note with a 15-year amortization schedule. In March 1998, this mortgage note was renegotiated to an interest rate of 7.875%. Terms are monthly principal and interest payments for 8.25 years with remaining principal due July 1, 2006. At September 30, 1998, \$4.9 million was outstanding on this facility.

The Company has notes payable to former shareholders that bear interest at a weighted rate of 15%, and have terms ranging from three to five 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 September 30, 1998, \$1.4 million was outstanding under these notes.

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. This grant requires that the German operation have employed 26 people by September 30, 1998. The Company anticipates that this headcount requirement will be met in the first half of 1999, and the Company believes that an extension may be available from the German authorities. If the Company fails to obtain an extension of time to meet the terms of the grant, then the \$0.4 million will be repaid. This amount has been recorded as a deferred grant. Therefore, the

repayment of the \$0.4 million would affect only cash and would have no effect on net income.

In Korea, the Company has various secured notes, denominated in Korean Won, and secured by property, plant and equipment, with interest payable at rates ranging from 6% to 15.5% and maturities ranging from December 1998 to March 2005. At September 30, 1998, \$0.8 million was outstanding under these credit facilities.

In August 1998, the Company settled a business interruption insurance claim of \$1.8 million with its insurance carrier. The claim was related to a fire in the manifold plant in the United States which occurred while the plant was under construction. The Company believes that this fire delayed the opening of the new plant which, in turn, delayed the rearrangement of the cartridge operation and the creation of the cellular production for high volume models. Expenses of \$0.1 million, and a tax effect of \$0.6 million were recorded in the third quarter of 1998 in the Company's financial statements related to this claim.

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 quarterly dividends of \$0.04 per share to shareholders of record on March 31, June 30, and September 30, 1998, which were paid on April 15, and July 15, and October 15, 1998, respectively.

YEAR 2000 READINESS DISCLOSURE

Management continues to evaluate the issues associated with the Year 2000. In general, these issues arise from the fact that many existing computer programs only use the last two digits to refer to a year. Accordingly, many of these computer programs will not properly recognize a year that begins with "20" instead of the familiar "19." If not corrected, these computer applications could fail or create erroneous results.

The Company currently is assessing the extent of its Year 2000 problem by (i) conducting an inventory of its systems, including hardware, software and embedded systems (such as the Company's CNC equipment), (ii) identifying critical applications, (iii) gathering internal source codes, and (iv) surveying the Company's material suppliers, distributors, and customers to determine their respective Year 2000 exposure.

The assessment phase will be followed by (i) a testing phase, during which all critical applications will be tested for Year 2000 readiness, (ii) a renovation phase, during which faulty systems will be corrected, replaced or retired, and (iii) a validation phase, during which upgraded systems will be re-tested. While the assessment phase remains underway in all locations, the Company has already commenced the replacement of the computer systems in two of its five

locations (the United States cartridge operation and the United Kingdom operation) with "enterprise manufacturing systems" that, according to representations made by the systems' manufacturers, are currently Year 2000 ready.

The Company expects all phases of its Year 2000 readiness plan to be completed by the end of the fourth quarter of 1998. There can, however, be no assurance that these deadlines will be met or precisely when the Company will be Year 2000 ready. The Company defines "Year 2000 ready" to mean that neither the performance nor functionality of any of its critical systems, including both information technology and non-information technology systems, will be materially affected by dates prior to, during and after the year 2000.

While management believes the Company could operate in a manual environment for a short period of time, the Company cannot currently estimate with any certainty the impact a failure to be Year 2000 ready would have on the Company's business and results of operations, nor has the Company developed a complete contingency plan to deal with this possibility, although it does anticipate establishing such a plan in the future. The Company does not expect the costs of the Company's readiness plan, including the cost of renovating any non-compliant systems, to significantly impact its results of operations. As with any new system implementation, however, there can be no assurance that the conversion will not significantly impact operations. Also, there can be no assurance that the systems of other companies on which the Company relies will be timely converted or that any such failure to convert by another company will not have an adverse effect on the Company's operations.

SEASONALITY AND INFLATION

The Company does not believe that inflation had a material effect on its operations for the nine months ended September 30, 1998 and September 30, 1997. 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; (vi) the Company's Year 2000 readiness plans and costs; and (vii) 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; (vi) the Company's ability to become Year 2000 ready, including the Company's ability to identify all critical systems that will be impacted by the Year 2000, the Company's ability, in a cost-efficient manner, to correct, upgrade or replace such systems, and the Year 2000 readiness of third parties with which the Company has material relationships; and (vii) 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 "Risk Factors" in the Form S-1 Registration Statement and Prospectus for the Company's initial public offering, and "Business" in the Company's Form 10-K for the year ended December 31, 1997. 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.

19

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.

Shareholder Proposals for Presentation at the 1999 Annual Meeting of Shareholders

As stated under the caption "Shareholder Proposals for Presentation at the 1999 Annual Meeting" in the Company's proxy statement dated April 24, 1998, the Board of Directors of the Company has requested that any shareholder proposals intended for presentation at the 1999 Annual Meeting be submitted in writing to Gregory C. Yadley, Secretary, no later than November 1, 1998, for consideration for inclusion in the Company's proxy materials for such meeting.

Further, the members of the Company's proxy committee will have discretionary voting authority with respect to all shares represented by proxies held by them at the Annual Meeting for any matters raised at the meeting about which the Company did not receive notice prior to March 8, 1999.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

20

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).
- 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 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).
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- 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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- 4.12 Consolidated Note, dated May 20, 1996, in the amount of \$3,063,157.00, given by Sun Hydraulics Corporation to Northern Trust Bank of Florida,

N.A. (previously filed as Exhibit 4.12 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference).

4.13 Loan Agreement, dated June 14, 1996, between Sun Hydraulics Corporation, Suninco Inc., and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.13 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference).

22

4.14 Mortgage, dated June 14, 1996, between Sun Hydraulics Corporation, Suninco Inc., and Northern Trust Bank of Florida, N.A. (previously filed as Exhibit 4.14 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference).

4.15 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 (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).

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).

23

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 Modification Note, dated March 1, 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).

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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10.3+ 1996 Sun Hydraulics Corporation Stock Option Plan (previously filed as Exhibit 10.3 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).

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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27.1 Financial Data Schedule for quarter ended September 30, 1998 (for SEC purposes only)

+ Executive management contract or compensatory plan or arrangement.

24

(b) Reports on Form 8-K.

None

25

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 12, 1998.

SUN HYDRAULICS CORPORATION

By /s/ Richard J. Dobbyn

:

EXHIBIT INDEX
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27.1 Financial Data Schedule for quarter ended September 30, 1998 (for SEC purposes only).

+ Executive management contract or compensatory plan or arrangement.

30

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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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<INCOME-TAX>	2,430
<INCOME-CONTINUING>	4,843
<DISCONTINUED>	0
<EXTRAORDINARY>	0
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<NET-INCOME>	4,843
<EPS-PRIMARY>	.76
<EPS-DILUTED>	.74

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