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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 April 2, 2005 Commission file number 0-21835

SUN HYDRAULICS CORPORATION

(Exact Name of Registration as Specified in its Charter)

FLORIDA	59-2754337
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
1500 WEST UNIVERSITY PARKWAY SARASOTA, FLORIDA	34243
(Address of Principal Executive Offices)	(Zip Code)

941/362-1200

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes☐ No ☑

The Registrant had 7,247,522 shares of common stock, par value $.001, outstanding as of May 6, 2005.

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PART I: FINANCIAL INFORMATION

Item 1.

Sun Hydraulics Corporation

Consolidated Balance Sheets

(in thousands, except share data)	April 2, 2005 (unaudited)	December 25, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 10,725	$ 9,300
Restricted cash	454	462
Accounts receivable, net of allowance for doubtful accounts of $141 and $170	12,006	8,611
Inventories	7,859	7,105
Deferred income taxes	392	392
Other current assets	1,091	776
Total current assets	32,527	26,646
Property, plant and equipment, net	43,426	43,687
Other assets	1,494	1,475
Total assets	**$ 77,447**	**$ 71,808**
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$ 3,150	$ 2,536
Accrued expenses and other liabilities	4,077	4,609
Long-term debt due within one year	1,037	1,058
Dividends payable	543	522
Taxes payable	759	1,198
Total current liabilities	9,566	9,923
Long-term debt due after one year	10,846	11,196
Deferred income taxes	4,989	4,986
Other noncurrent liabilities	295	300
Total liabilities	25,696	26,405
Commitments and contingencies	—	—
Shareholders' equity:		
Preferred stock, 2,000,000 shares authorized, par value $0.001, no shares outstanding	—	—
Common stock, 20,000,000 shares authorized, par value $0.001, 7,234,833 and 6,961,280 shares outstanding	7	7
Capital in excess of par value	32,210	28,579
Unearned compensation related to outstanding restricted stock	(532)	(608)
Retained earnings	16,793	13,870
Accumulated other comprehensive income	3,273	3,566
Treasury stock	—	(11)
Total shareholders' equity	51,751	45,403
Total liabilities and shareholders' equity	**$ 77,447**	**$ 71,808**

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

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Sun Hydraulics Corporation

Consolidated Statements of Operations

(in thousands, except per share data)	Three months ended April 2, 2005 (unaudited)	Three months ended March 27, 2004 (unaudited)
Net sales	**$ 29,079**	**$ 21,390**
Cost of sales	19,326	15,085
Gross profit	**9,753**	**6,305**
Selling, engineering and administrative expenses	4,220	4,064
Operating income	**5,533**	**2,241**
Interest expense	136	148
Foreign currency transaction gain	(105)	(2)
Miscellaneous expense, net	(16)	13
Income before income taxes	**5,518**	**2,082**
Income tax provision	2,052	724
Net income	**$ 3,466**	**$ 1,358**
Basic net income per common share	**$ 0.49**	**$ 0.20**
Weighted average basic shares outstanding	7,088	6,758
Diluted net income per common share	**$ 0.48**	**$ 0.20**
Weighted average diluted shares outstanding	7,149	6,802
Dividends declared per share	**$ 0.075**	**$ 0.040**

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

Sun Hydraulics Corporation

Consolidated Statement of Changes in Shareholders' Equity and Comprehensive Income (unaudited)

(in thousands)	Shares	Preferred stock	Common stock	Capital in excess of par value	Unearned compensation related to restricted stock	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
Balance, December 25, 2004	6,961	$ —	$ 7	$ 28,579	$ (608)	$13,870	$ 3,566	$ (11)	45,403
Recognition of unearned compensation, restricted stock					76				76
Shares issued, stock options	274			2,061					2,061
Shares issued, ESPP				32					32
Shares issued, ESOP				1,058					1,058
Purchase and retirement of treasury stock				(38)				11	(27)
Stock option income tax benefit				518					518
Dividends declared						(543)			(543)
Comprehensive income:									
Net income						3,466			3,466
Foreign currency translation adjustments							(293)		(293)
Comprehensive income									3,173
Balance, April 2, 2005	7,235	$ —	$ 7	$ 32,210	$ (532)	$16,793	$ 3,273	$ —	$51,751

The accompanying Notes to the Consolidated, Unaudited Financial Statements are an integral part of this financial statement.

Sun Hydraulics Corporation

Consolidated Statements of Cash Flows

(in thousands)	Three Months ended April 2, 2005 (unaudited)	Three Months ended March 27, 2004 (unaudited)
Cash flows from operating activities:		
Net income	$ 3,466	$ 1,358
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,390	1,327
Loss on disposal of assets	(1)	13
Provision for deferred income taxes	3	(87)
Allowance for doubtful accounts	(29)	20
Stock-based compensation expense	81	65
(Increase) decrease in:		
Accounts receivable	(3,366)	(2,858)
Inventories	(754)	(245)
Other current assets	(315)	(6)
Other assets	(19)	117
Increase (decrease) in:		
Accounts payable	614	300
Accrued expenses and other liabilities	526	744
Taxes payable	79	491
Other liabilities	(5)	(13)
Net cash provided by operating activities	1,670	1,226
Cash flows from investing activities:		
Capital expenditures	(1,538)	(968)
Proceeds from dispositions of equipment	1	17
Net cash used in investing activities	(1,537)	(951)
Cash flows from financing activities:		
Repayment of debt	(371)	(806)
Proceeds from exercise of stock options	2,056	—
Proceeds from stock issued	32	—
Payments for purchase of treasury stock	(27)	(25)
Proceeds from reissuance of treasury stock	—	28
Dividends to shareholders	(522)	(270)
Net cash provided by (used in) financing activities	1,168	(1,073)
Effect of exchange rate changes on cash and cash equivalents	116	19
Net increase in cash and cash equivalents	1,417	(779)
Cash and cash equivalents, beginning of period	**9,762**	**5,219**
Cash and cash equivalents, end of period	**$ 11,179**	**$ 4,440**
Supplemental disclosure of cash flow information:		
Cash paid:		
Interest	$ 136	$ 148
Income taxes	$ 2,488	$ 320

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

SUN HYDRAULICS CORPORATION

NOTES TO THE CONSOLIDATED, UNAUDITED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)

1. BASIS OF PRESENTATION AND SUMARY OF BUSINESS

Sun Hydraulics Corporation, its wholly-owned subsidiaries and joint venture design, manufacture, and sell screw-in cartridge valves and manifolds used in hydraulic systems. The Company has facilities in the United States, the United Kingdom, Germany, Korea, and China. Sun Hydraulics Corporation (“Sun Hydraulics”), with its main offices located in Sarasota, Florida, designs, manufactures, and sells primarily through distributors. Sun Hydraulik Holdings Limited (“Sun Holdings”), a wholly-owned subsidiary of Sun Hydraulics, was formed to provide a holding company for the European market operations; its wholly-owned subsidiaries are Sun Hydraulics Limited (a British corporation, “Sun Ltd.”) and Sun Hydraulik GmbH (a German corporation, “Sun GmbH”). Sun Ltd. operates a manufacturing and distribution facility located in Coventry, England, and Sun GmbH operates a manufacturing and distribution facility located in Erkelenz, Germany. Sun Hydraulics Korea Corporation (“Sun Korea”), a wholly-owned subsidiary of Sun Hydraulics, located in Inchon, South Korea, operates a manufacturing and distribution facility. Sun Hydraulics, SARL (“Sun France”), a wholly owned subsidiary of Sun Hydraulics, located in Bordeaux, France, operates a sales and engineering support facility. Sun Hydraulics Systems (Shanghai) Co., Ltd. (“Sun China”), a 50/50 joint venture between Sun Hydraulics and Links Lin, the owner of Sun Hydraulics’ Taiwanese distributor, is located in Shanghai, China, and operates a manufacturing and distribution facility.

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 accounting principles generally accepted in the United States of America 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 25, 2004, filed by Sun Hydraulics Corporation (together with its subsidiaries, the “Company”) with the Securities and Exchange Commission on March 24, 2005. In Management’s opinion, all adjustments necessary for a fair presentation of the Company’s financial statements are reflected in the interim periods presented. Operating results for the three months period ended April 2, 2005, are not necessarily indicative of the results that may be expected for the period ended December 31, 2005.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Stock-Based Compensation

The Company has adopted the disclosure only provisions of Statements of Financial Accounting Standards (FAS) No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosure, an amendment to FAS No. 123, Accounting for Stock-Based Compensation* (“FAS 148”), and has elected to follow Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees* and related interpretations in accounting for its employee stock options. Under APB 25, because the exercise price of employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recorded.

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If the company had elected to recognize compensation expense for stock options based on the fair value at grant date, consistent with the method prescribed by FAS No. 123, *Accounting for Stock-Based Compensation* ("FAS 123"), net income and earnings per share would have been reduced to the pro forma amounts below. The pro forma amounts were determined using the Black-Scholes valuation model with weighted average assumptions as set forth below.

	Three Months Ended	
	April 2, 2005	March 27, 2004
Net Income as Reported	$ 3,466	$ 1,358
Stock-based compensation reported in net income, net of related taxes	48	41
Stock compensation expense calculated under FAS 123, net of related taxes	(78)	(63)
Pro Forma Net Income	$ 3,436	$ 1,336
Basic net income per common share:		
As reported	$ 0.49	$ 0.20
Pro forma	$ 0.48	$ 0.20
Diluted net income per common share:		
As reported	$ 0.48	$ 0.20
Pro forma	$ 0.48	$ 0.20
Assumptions		
Risk-free interest rate	4.22%	3.84%
Expected lives (in years)	6.5	6.5
Expected volatility	30.32%	40.00%
Dividend yield	2.19%	2.00%

Earnings per share

The following table represents the computation of basic and diluted earnings per common share as required by FAS No. 128, *Earnings Per Share* (in thousands, except per share data):

	Three Months Ended	
	April 2, 2005	**March 27, 2004**
Net income	**$ 3,466**	**$ 1,358**
Weighted average basic shares outstanding	7,088	6,758
Basic income per common share	**$ 0.49**	**$ 0.20**
Effect of dilutive stock options	61	44
Weighted average diluted shares outstanding	7,149	6,802
Diluted income per common share	**$ 0.48**	**$ 0.20**

Diluted earnings per common share excludes antidilutive stock options of approximately 276,000 for the period ended March 27, 2004.

Reclassification

Certain amounts shown in the 2004 consolidated financial statements have been reclassified to conform to the 2005 presentation.

52-53 Week Fiscal Year

The Company’s fiscal year ends on the Saturday nearest to the end of the month of December. Each quarter consists of two 4-week periods and one 5-week period. The 2005 fiscal year will end on December 31, 2005, resulting in a 53-week year. As a result of the 2004 fiscal year ending December 25, 2004, the period ending April 2, 2005 consists of one 4-week period and two 5-week periods.

3. RESTRICTED CASH

The restricted cash balance at April 2, 2005, consisted of $454 in reserves as a required deferment for customs and excise taxes in the U.K. operation. The restricted amount was calculated as an estimate of two months of customs and excise taxes for items coming into the Company’s U.K. operations and was held with Lloyd’s TSB in the U.K.

4. INVENTORIES

	April 2, 2005	December 25, 2004
Raw materials	$ 2,733	$ 2,523
Work in process	3,064	2,487
Finished goods	2,342	2,402
Provision for slow moving inventory	(280)	(307)
Total	$ 7,859	$ 7,105

5. GOODWILL

On April 2, 2005, the Company had $715 of goodwill, related to its acquisition of Sun Korea. Goodwill is held in other assets on the balance sheet. Valuation models reflecting the expected future cash flow projections were used to value Sun Korea at December 25, 2004. The analysis indicated that there was no impairment on the carrying value of the goodwill. As of April 2, 2005, no factors were identified that indicated impairment on the carrying value of the goodwill.

6. LONG-TERM DEBT

	April 2, 2005	December 25, 2004
$11,000 five-year note, collateralized by U.S. real estate and equipment and a 65% stock pledge in the foreign subsidiaries, interest rate Libor + 1.9% or prime rate at Company's discretion (4.62% at April 2, 2005), due July 23, 2008	$ 10,083	$ 10,220
$12,000 revolving line of credit, collateralized by U.S. real estate and equipment and a 65% stock pledge in the foreign subsidiaries, interest rate Libor + 1.9% or prime rate at Company's discretion (4.62% at April 2, 2005), due July 23, 2006	—	—
$2,400 12-year mortgage note on the German facility, fixed interest rate of 6.05%, due September 30, 2008	851	947
10-year notes, fixed interest rates ranging from 3.5-5.1%, collateralized by equipment in Germany, due between 2009 and 2011	879	1,009
Other	70	78
	11,883	12,254
Less amounts due within one year	(1,037)	(1,058)
Total	$ 10,846	$ 11,196

Certain of these debt instruments are subject to debt covenants including 1) Fixed Charges Coverage Ratio (as defined) of 2.0 to 1.0, determined quarterly on a rolling four quarters basis, 2) Debt (as defined) to Tangible Net Worth (as defined) of not more than 1.5 to 1.0, determined quarterly, 3) Current Ratio of 1.5 to 1.0, determined quarterly, 4) Funded Debt (as defined) to EBITDA of less than 3.25 to 1.0, determined quarterly on a rolling four quarters basis, and 5) the Company's primary domestic depository accounts must be held at SouthTrust Bank. As of April 2, 2005, the Company was in compliance with all debt covenants.

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7. SEGMENT REPORTING

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

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

Segment information is as follows:

	United States	Korea	Germany	United Kingdom	Elimination	Consolidated
Three Months Ended April 2, 2005						
Sales to unaffiliated customers	$18,146	$ 2,667	$ 4,081	$ 4,185	$ —	$ 29,079
Intercompany sales	5,862	—	23	602	(6,487)	—
Operating income/(loss)	3,872	330	1,174	318	(161)	5,533
Depreciation	977	37	109	267	—	1,390
Capital expenditures	1,375	5	61	97	—	1,538
Three Months Ended March 27, 2004						
Sales to unaffiliated customers	$12,918	$ 2,296	$ 2,996	$ 3,180	$ —	$ 21,390
Intercompany sales	3,723	—	12	355	(4,090)	—
Operating income/(loss)	1,490	264	526	(34)	(5)	2,241
Depreciation	920	35	99	273	—	1,327
Capital expenditures	800	4	30	134	—	968

Operating income is total sales and other operating income less operating expenses. In computing segment operating income/(loss), 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 $3,157 and $2,318 during the three months ended April 2, 2005, and March 27, 2004, respectively.

8. NEW ACCOUNTING PRONOUNCEMENTS

In November 2004, the FASB issued FAS No. 151 ("FAS 151"), *Inventory Costs, an amendment of ARB No. 43, Chapter 4*. The amendments made by FAS 151 clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. While FAS 151 enhances Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins,* and clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage), the statement also removes inconsistencies between ARB 43 and International Accounting Standards No. 2 ("IAS 2") and amends ARB 43 to clarify that abnormal amounts of costs should be recognized as period costs. Under some circumstances, according to ARB 43, the above listed costs may be so abnormal as to require treatment as current period charges. FAS 151 requires these items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal" and requires allocation of fixed production overheads to the costs of conversion.

This standard will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The impact of the adoption of FAS 151 on the Company's reported operating results, financial position and existing financial statement disclosure is not expected to be material.

In December, 2004, the FASB issued FAS No. 123 (revised 2004) ("FAS 123(R)"), *Share-Based Payment*, which is a revision of FAS 123. FAS 123(R) supersedes APB 25 and FAS 123, and amends FAS No. 95, *Statement of Cash Flows*. This Statement requires entities to recognize the cost of employee services received in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). This Statement eliminates the alternative to use APB 25's intrinsic value method of accounting that was provided in FAS 123 as originally issued. Under APB 25, issuing stock options to employees at or above fair value generally resulted in no recognition of compensation cost.

FAS 123(R) also requires that the Company estimate the number of awards that are expected to vest and to revise the estimate as the actual forfeitures differ from the estimate. This standard is effective as of the beginning of the first annual reporting period that begins after June 15, 2005. The effect of these items and other changes in FAS 123(R) as well as the potential impact on the Company's reported operating results, financial position and existing financial statement disclosure is currently being evaluated.

FAS 123(R) requires that the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow; thus, reducing net operating cash flows and increasing net financing cash flows in the periods after the effective date. The Company cannot estimate what these amounts will be in the future because they depend on, among other things, when employees exercise stock options.

The Company currently follows the disclosure only provisions of FAS 148, and has elected to follow APB 25 and related interpretations in accounting for its employee stock options. The Company uses the Black-Scholes formula to estimate the value of stock options granted to employees for disclosure purposes. FAS 123(R) requires that we use the valuation technique that best fits the circumstances. The Company is currently evaluating other techniques.

In December 2004, the FASB issued FASB Staff Position ("FSP") 109-1 ("FSP 109-1") and 109-2 ("FSP 109-2"). FSP 109-1 provides guidance on the application of FAS No. 109, *Accounting for Income Taxes* ("FAS 109"), with regard to the tax deduction on qualified production activities provision within H.R. 4520, The American Jobs Creation Act of 2004 ("Act"), that was enacted on October 22, 2004. FSP 109-2 provides guidance on a special one-time dividends received deduction on the repatriation of certain foreign earnings to qualifying U.S. taxpayers. The Act contains numerous provisions related to corporate and international taxation including repeal of the Extraterritorial Income (ETI) regime, creation of a new Domestic Production Activities (DPA) deduction and a temporary dividends received deduction related to repatriation of foreign earnings. The Act contains various effective dates and transition periods. Under the guidance provided in FSP 109-1, the new DPA deduction will be treated as a "special deduction" as described in FAS 109. As such, the special deduction has no effect on the Company's deferred tax assets and liabilities existing at the enactment date. Rather, the impact of this deduction will be reported in the period in which the deduction is claimed on the Company's income tax return. The Company does not expect the net effect of the phase-out of the ETI deduction and phase-in of the new DPA deduction to result in a material impact on its effective income tax rate in 2005.

In FSP 109-2, the FASB acknowledged that, due to the proximity of the Act's enactment date to many companies' year-ends and the fact that numerous provisions within the Act are complex and pending further regulatory guidance, many companies might not be in a position to assess the impacts of the Act on their plans for repatriation or reinvestment of foreign earnings. Therefore, the FSP provided companies with a practical exception to the permanent reinvestment standards of FAS 109 and APB No. 23, *Accounting for Income Taxes — Special Areas,* by providing additional time to determine the amount of earnings, if any, that they intend to repatriate under the Act's provisions. The Company is not yet in a position to decide whether, and to what extent, it might repatriate foreign earnings to the

U.S. Therefore, under the guidance provided in FSP 109-2, no deferred tax liability has been recorded in 2005 in connection with the repatriation provisions of the Act. The Company is currently analyzing the future impact of the temporary dividends received deduction provisions contained in the Act.

9. COMMITMENTS AND CONTINGENCIES

The Company is not a party to any legal proceedings other than routine litigation incidental to its business. In the opinion of management, the amount of ultimate liability with respect to these actions will not materially affect the results of operations, financial position or cash flows of the Company.

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 through wholly owned companies and independent distributors with some direct accounts. Sales outside the United States for the Quarter ended April 2, 2005, were 50% of total net sales.

Approximately 66% of product sales are used by the mobile market, which is 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. Some examples of mobile equipment include off-road construction equipment, fire and rescue equipment and mining machinery.

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, and which operates at higher pressures and duty cycles. Automation machinery, metal cutting machine tools and plastics machinery are some examples of industrial equipment. The Company sells to both markets with a single product line.

Industry conditions

Demand for the Company's products is dependent on demand for the capital goods into which the products are incorporated. The capital goods industries in general, and the fluid power industry specifically, are subject to economic cycles. According to the National Fluid Power Association (the fluid power industry's trade association in the United States), the United States index of shipments of hydraulic products decreased -16%, -3% and -2% in 2001, 2002 and 2003, respectively. This trend reversed in 2004 as the United States index of shipments of hydraulics products increased 25%.

The Company's order trend has historically tracked closely to the United States Purchasing Managers Index (PMI). The index was 55.2 at the end of March 2005 compared to 62.5 at the end of March 2004. When PMI is over 50, it indicates economic expansion; when it is below 50, it indicates contraction in the economy.

Results for the first quarter

(Dollars in millions except net income per share)	April 2, 2005	March 27, 2004	Increase
Three Months Ended			
Net Sales	$ 29.1	$ 21.4	36%
Net Income	$ 3.5	$ 1.4	150%
Net Income per share:			
Basic	$ 0.49	$ 0.20	145%
Fully Diluted	$ 0.48	$ 0.20	140%

2004 was an excellent year for Sun in all respects and 2005 is shaping up to be better than last year. Orders continue to be strong and demand is up in all of the Company's markets.

Orders for the first quarter of 2005 were $30.8 million, a 25% increase over the first quarter last year. April orders were $10.1 million, a 23% increase over last year. The Company believes second quarter sales will be higher than the first quarter, despite fewer shipping days, and it expects to maintain its on-time delivery performance.

The Company believes its strong financial condition and long term success are largely due to its philosophy of maintaining “balance” in its business, both externally and internally. As stated in its just released 2004 annual report, balancing the interests of its customers, shareholders, employees, distributors and suppliers will remain at the heart of the Company’s efforts.

Outlook

The Company estimates sales for the second quarter will be approximately $30.0 million, a 13% increase over the second quarter last year. Non-recurring refinancing costs and increased marketing expenses totaling $0.5 million are anticipated in the second quarter. Net income is forecasted to be between $0.45 and $0.48 per share.

COMPARISON OF THREE MONTHS ENDED APRIL 2, 2005 AND MARCH 27, 2004

Net Sales

Net sales were $29.1 million, an increase of $7.7 million, or 36.0%, compared to $21.4 million in 2004. The increase was due in large part to the economic recovery in the manufacturing sector, particularly in North America where sales increased 43.6%, as shipments within the U.S. increased 40.9% and Canadian shipments increased 70.7%.

European sales increased 43.1%, or $2.6 million, to $8.7 million. Sales to France increased 89.1%, to Germany 31.1%, and to the U.K. 12.8%. Significant increases were also noted in Sweden, Finland, Italy and the Netherlands.

Asian sales increased 13.6%, or $0.5 million, to $3.8 million, led by domestic sales in Korea and China.

Gross Profit

Gross profit increased $3.5 million, or 54.7%, to $9.8 million. Gross profit as a percentage of net sales increased to 33.5% in the first quarter of 2005, compared to 29.5% in the first quarter last year. The increase was due primarily to the incremental sales increase of 36%. A moderate and selective sales price increase in January this year, coupled with improved productivity, offset the increased material cost of parts and raw materials.

Selling, Engineering, and Administrative Expenses

Selling, engineering and administrative expenses increased 3.8%, or $0.2 million, to $4.2 million compared to the same quarter last year. The increase was primarily due to increased accounting and contract labor fees related to 2005, including Sarbanes-Oxley 404 compliance.

Interest Expense

Interest expense for the quarter ended April 2, 2005, remained flat at $0.1 million compared to the quarter ended March 27, 2004. Total average debt for the quarter ended April 2, 2005, was $12.1 million compared to $18.4 million for the quarter ended March 27, 2004. Although average debt outstanding decreased by $6.3 million, the average interest rate during the first quarter of 2005 was 4.3%, compared to 3% in 2004.

Foreign Currency Transaction (Gain) Loss

Foreign currency gains were $0.1 million for the quarter ended April 2, 2005. While the Euro, the Korean Won and the British Pound made gains against the U.S. dollar in the first quarter of 2005, the U.K.

operations experienced losses related to sales conducted in U.S. dollars. There was no effect on income from foreign currency transactions for the quarter ended March 27, 2004.

Income Taxes

The provision for income taxes for the quarter ended April 2, 2005, was 37.2% of pretax income compared to 34.8% for the quarter ended March 27, 2004. The change was due to the relative mix of income and different tax rates in effect among the countries in which the Company sells its products.

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 from time to time 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 from operations for the three months ended April 2, 2005, was $1.7 million, compared to $1.2 million for the quarter ended March 27, 2004. The $2.1 million increase in net income was offset by working capital changes related to increased volume. Days sales outstanding (DSO) remained unchanged at 39 as of April 2, 2005, and March 27, 2004. Inventory turns improved to 9.8 as of April 2, 2005, from 9.0 as of March 27, 2004.

Capital expenditures, consisting primarily of purchases of machinery and equipment, were $1.5 million for the three months ended April 2, 2005, compared to $1.0 million for the quarter ended March 27, 2004. Capital expenditures for the year are projected to be approximately $5.0 million.

The Company declared quarterly dividends of $0.075 per share to shareholders of record March 31, 2005, payable on April 15, 2005. The declaration and payment of future dividends is subject to the sole discretion of the Board of Directors, and any determination as to the payment of future dividends will depend upon the Company’s profitability, financial condition, capital needs, future prospects and other factors deemed pertinent by the Board of Directors.

The Company believes that cash generated from operations and its borrowing availability under its revolving Line of Credit will be sufficient to satisfy the Company’s operating expenses and capital expenditures for the foreseeable future. In the event that economic conditions were to severely worsen for a protracted period of time, the Company would have several options available to ensure liquidity in addition to increased borrowing. Capital expenditures could be postponed since they primarily pertain to long-term improvements in operations. Additional operating expense reductions also could be made. Finally, the dividend to shareholders could be reduced or suspended.

Off Balance Sheet Arrangements

The Company uses the equity method of accounting to account for investments in its joint venture in China in which it does not have a majority ownership or exercise control. The Company does not believe that its investment in the China Joint Venture is a Variable Interest Entity and within the scope of FASB Interpretation (FIN) No. 46, *Consolidation of Variable Interest Entities, an interpretation of ARB No. 5,* nor is it material to the financial statements of the Company at April 2, 2005.

Seasonality

The Company generally has experienced increased sales during the second quarter of the year, largely as a result of the order patterns of our customers. As a result, the Company’s second quarter net sales, income from operations and net income historically are the highest of any quarter during the year.

Inflation

The impact of inflation on the Company's operating results has been moderate in recent years, reflecting generally lower rates of inflation in the economy. While inflation has not had, and the Company does not expect that it will have, a material impact upon operating results, there is no assurance that the Company's business will not be affected by inflation in the future.

Critical Accounting Policies and Estimates

The Company currently only applies judgment and estimates which may have a material effect on the eventual outcome of assets, liabilities, revenues and expenses for impairment of long-lived assets, accounts receivable, inventory, goodwill and accruals. The following explains the basis and the procedure for each account where judgment and estimates are applied.

Revenue Recognition

The Company reports revenues, net of sales incentives, when title passes and risk of loss transfers to the customer. The effect of material non-recurring events is provided for when they become known.

Impairment of Long-Lived Assets

In accordance with Statement of Financial Accounting Standards ("FAS") No. 144,*Accounting for Impairment or Disposal of Long-lived Assets* ("FAS 144"), long-lived assets, such as property and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the asset is measured by comparison of its carrying amount to future net cash flows the asset is expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds its fair market value.

The Company assesses the recoverability of goodwill and intangible assets not subject to amortization under FAS No. 142, *Goodwill and Other Intangible Assets* ("FAS 142"). See Goodwill below.

Accounts Receivable

The Company sells to most of its customers on a recurring basis, primarily through distributors with which the Company maintains long-term relationships. As a result, bad debt experience has not been material. The allowance for doubtful accounts is determined on a specific identification basis by a review of those accounts that are significantly in arrears. There can be no assurance that a distributor or a large direct sale customer with overdue accounts receivable balances will not develop financial difficulties and default on payment. See balance sheet for allowance amounts.

Inventory

The Company offers a wide variety of standard products and as a matter of policy does not discontinue products. On an ongoing basis, component parts found to be obsolete through design or process changes are disposed of and charged to material cost. The Company reviews on-hand balances of products and component parts against specific criteria. Products and component parts without usage or that have excess quantities on hand are evaluated. An inventory reserve is then established for the full inventory carrying value of those products and component parts deemed to be obsolete or slow moving. See Note 4 for inventory reserve amounts.

Goodwill

The Company acquired its Korean operations in September 1998 using the purchase method. As a result, goodwill is reflected on the consolidated balance sheet. A valuation based on the cash flow method was performed at December 25, 2004. It was determined that the value of the goodwill was not impaired. There is no assurance that the value of the acquired company will not decrease in the future due to changing business conditions. See Note 5 for goodwill amounts.

Accruals

The Company makes estimates related to certain employee benefits and miscellaneous accruals. Estimates for employee benefit accruals are based on information received from plan administrators in conjunction with management's assessments of estimated liabilities related to workers' compensation, the ESOP contribution, and health care benefits. Estimates for miscellaneous accruals are based on management's assessment of estimated liabilities for costs incurred.

FORWARD-LOOKING INFORMATION

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

Important factors that could cause the actual results to differ materially from those in the forward-looking statements include, among other items, (i) the economic cyclicality of the capital goods industry in general and the hydraulic valve and manifold industry in particular, which directly affect customer orders, lead times and sales volume; (ii) conditions in the capital markets, including the interest rate environment and the availability of capital; (iii) changes in the competitive marketplace that could affect the Company's revenue and/or cost bases, such as increased competition, lack of qualified engineering, marketing, management or other personnel, and increased labor and raw materials costs; (iv) changes in technology or customer requirements, such as standardization of the cavity into which screw-in cartridge valves must fit, which could render the Company's products or technologies noncompetitive or obsolete; (v) new product introductions, product sales mix and the geographic mix of sales nationally and internationally; and (vi) changes relating to the Company's international sales, including changes in regulatory requirements or tariffs, trade or currency restrictions, fluctuations in exchange rates, and tax and collection issues. Further information relating to factors that could cause actual results to differ from those anticipated is included but not limited to information under the headings "Business" (including under the subheading "Business Risk Factors") in the Company's Form 10-K for the year ended December 25, 2004, and "Management's Discussion and Analysis of Financial Conditions and Results of Operations" in this Form 10-Q for the quarter ended April 2, 2005. 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.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk from changes in interest rates on borrowed funds, which could affect its results of operations and financial condition. The Company had approximately $10.2 million in variable-rate debt outstanding at April 2, 2005. The Company has managed this risk by its ability to select the interest rate on its debt financing at Libor plus 1.9% or its lender's prime rate, whichever is more advantageous. Beginning in July 2004, the interest rate on its debt financing will remain variable based upon the Company's leverage ratio. At April 2, 2005, a 1% change in interest rates up or down would affect the Company's income statement on an annual basis by approximately $102,000 at the current, variable-rate outstanding debt level. At March 27, 2004, the Company had $15.2 million in variable-rate debt outstanding and, as such, a 1% change in interest rates up or down would have affected the Company's income statement on an annual basis by approximately $152,000.

The Company's exposure to foreign currency exchange fluctuations relates primarily to the direct investment in its facilities in the United Kingdom, Germany, and Korea. The Company does not use financial instruments to hedge foreign currency exchange rate changes.

Item 4. CONTROLS AND PROCEDURES

As of April 2, 2005, the Company's management, under the direction of its Chief Executive Officer and the Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of the disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of April 2, 2005, in timely alerting them to material information required to be included in the Company's periodic SEC filings.

There were no significant changes in the Company's internal controls over financial reporting during the period ended April 2, 2005, that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings.

None.

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

In November, 2004, the Company's Board of Directors authorized the repurchase of up to $2.5 million of Company stock, to be completed no later than January 15, 2006. The stock purchases will be made in the open market or through privately negotiated transactions. Market purchases will be made subject to restrictions relating to volume, price and timing in an effort to minimize the impact of the purchases on the market for the Company's securities. The amount of the stock repurchases was set based upon the anticipated number of shares that will be required to fund the Company's ESOP, and employee stock purchase plan, through fiscal year 2005.

The Company had repurchased 1,800 shares on the open market at an average cost of $14.70 per share during the first quarter of 2005. All 1,800 shares have been retired by the Company. The total number of shares purchased through the plan at April 2, 2005 was 7,600. There is approximately $2.4 million of Company stock that may still be purchased by the Company.

Item 3. Defaults upon Senior Securities.

None.

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

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibits:

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 Company's Quarterly Report on Form 10-Q for the quarter ended October 2, 1999 and incorporated herein by reference).
3.2.1	Certificate of Amendment to Amended and Restated Bylaws of the Company (previously filed as Exhibit 3.2.1 in the Company's Quarterly Report on Form 10-Q for the quarter ended March 27, 2004 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).
10.2	Form of Distributor Agreement (International) (previously filed as Exhibit 10.2 in the Company's Registration Statement on Form S-1 filed on October 15, 1996 (File No. 333-14183) and incorporated herein by reference).

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).
10.5	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).
10.6+	Form of Indemnification Agreement (previously filed as Exhibit 10.4 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).
10.7+	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).
10.8+	2001 Sun Hydraulics Corporation Restricted Stock Plan (previously filed as Exhibit 4 to the Company's Registration Statement on Form S-8 filed on June 12, 2001 (file No. 333-62816), and incorporated herein by reference).
10.9+	Sun Hydraulics Corporation Employee Stock Purchase Plan (previously filed as Exhibit 4 to the Company's Registration Statement on Form S-8 filed on July 27, 2001 (file No. 333-66008), and incorporated herein by reference).
10.10	Credit and Security Agreement dated July 23, 2003, between the Company, Sun Hydraulik Holdings Limited and Sun Hydraulics Limited as Borrower, and SouthTrust Bank as Lender (previously filed as Exhibit 10.10 in the Company's Quarterly Report on Form 10-Q for the quarter ended June 28, 2003 and incorporated herein by reference).
10.11	Master Loan Documents Modification Agreement dated as of November 18, 2003, between the Company as Borrower, and SouthTrust Bank as Lender (previously filed as Exhibit 10.11 in the Company's Annual Report on Form 10-K for the year ended December 27, 2003 and incorporated herein by reference).
10.12+	Forms of agreement for grants under the Sun Hydraulics Corporation 1996 Stock Option Plan (previously filed as Exhibit 10.12+ to the Company's Quarterly Report on Form 10-Q for the quarter ended September 25, 2004 and incorporated herein by reference).
10.13+	Sun Hydraulics Corporation 2004 Nonemployee Director Equity and Deferred Compensation Plan (previously filed as Appendix A to the Registrant's Proxy Statement for the 2004 Annual Meeting of Shareholders, filed with the Commission on May 3, 2004 and incorporated herein by reference).
10.14+	Form of Performance Share Agreement (previously filed as Exhibit 99.1 to the Company's Form 8-K filed on December 16, 2004 and incorporated herein by reference).
10.15+	The Sun Hydraulics Corporation 401(k) and ESOP Retirement Plan (previously filed as Exhibit 99.1 to the Company's Form 8-K filed on January 14, 2005 and incorporated herein by reference).

31.1	CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	CEO Certification pursuant to 18 U.S.C. § 1350.
32.2	CFO Certification pursuant to 18 U.S.C. § 1350.

\+ Executive management contract or compensatory plan or arrangement.

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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 May 16, 2005.

SUN HYDRAULICS CORPORATION

By: /s/ Richard J. Dobbyn

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

Exhibit 31.1

CERTIFICATION

I, Allen J. Carlson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended April 2, 2005, of Sun Hydraulics Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 16, 2005

/s/ Allen J. Carlson

Allen J. Carlson
President, Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Richard J. Dobbyn, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended April 2, 2005, of Sun Hydraulics Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 16, 2005

/s/ Richard J. Dobbyn

Richard J. Dobbyn
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. § 1350

I, Allen Carlson, the Chief Executive Officer of Sun Hydraulics Corporation (the "Company"), certify that (i) the Quarterly Report on Form 10-Q for the Company for the quarter ended April 2, 2005 (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Allen Carlson

Chief Executive Officer
May 16, 2005

EXHIBIT 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. § 1350

I, Richard J. Dobbyn, the Chief Financial Officer of Sun Hydraulics Corporation (the “Company”), certify that (i) the Quarterly Report on Form 10-Q for the Company for the quarter ended April 2, 2005 (the “Report”), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Richard J. Dobbyn

Chief Financial Officer

May 16, 2005