UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 29, 2012 | Commission file number 0-21835

SUN HYDRAULICS CORPORATION

(Exact Name of Registration as Specified in its Charter)

FLORIDA (State or Other Jurisdiction of Incorporation or Organization)	**59-2754337** (I.R.S. Employer Identification No.)
1500 WEST UNIVERSITY PARKWAY SARASOTA, FLORIDA (Address of Principal Executive Offices)	**34243** (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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐	Accelerated filer ☒
Non-accelerated filer ☐	Smaller Reporting Company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The Registrant had 26,090,080 shares of common stock, par value $.001, outstanding as of October 26, 2012.

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For the quarter ended September 29, 2012

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PART I: FINANCIAL INFORMATION

Item 1.

Sun Hydraulics Corporation

Consolidated Balance Sheets

(in thousands, except share data)

	September 29, 2012 (unaudited)	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 50,742	$ 45,080
Restricted cash	49	46
Accounts receivable, net of allowance for doubtful accounts of $127 and $83	18,492	16,227
Inventories	12,976	12,829
Income taxes receivable	—	120
Deferred income taxes	260	260
Marketable securities	46,985	28,014
Other current assets	1,268	1,354
Total current assets	130,772	103,930
Property, plant and equipment, net	58,900	56,959
Other assets	6,566	6,639
Total assets	**$ 196,238**	**$ 167,528**
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$ 4,467	$ 4,402
Accrued expenses and other liabilities	6,781	7,466
Income taxes payable	1,047	—
Dividends payable	2,339	2,318
Total current liabilities	14,634	14,186
Deferred income taxes	6,921	6,917
Other noncurrent liabilities	—	1,149
Total liabilities	21,555	22,252
Commitments and contingencies	—	—
Shareholders' equity:		
Preferred stock, 2,000,000 shares authorized, par value $0.001, no shares outstanding	—	—
Common stock, 40,000,000 shares authorized, par value $0.001, 25,992,248 and 25,756,442 shares outstanding	26	26
Capital in excess of par value	56,426	48,944
Retained earnings	119,002	98,426
Accumulated other comprehensive loss	(771)	(2,120)
Total shareholders' equity	174,683	145,276
Total liabilities and shareholders' equity	**$ 196,238**	**$ 167,528**

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

Sun Hydraulics Corporation

Consolidated Statements of Operations

(in thousands, except per share data)

	Three months ended	
	September 29, 2012 (unaudited)	October 1, 2011 (unaudited)
Net sales	$ **48,825**	$ **53,041**
Cost of sales	29,428	32,293
Gross profit	**19,397**	**20,748**
Selling, engineering and administrative expenses	6,202	5,249
Operating income	**13,195**	**15,499**
Interest income, net	(406)	(241)
Foreign currency transaction loss, net	2	50
Miscellaneous (income) expense, net	6	(1,292)
Income before income taxes	**13,593**	**16,982**
Income tax provision	4,758	5,588
Net income	$ **8,835**	$ **11,394**
Basic net income per common share	$ **0.34**	$ **0.44**
Weighted average basic shares outstanding	25,989	25,652
Diluted net income per common share	$ **0.34**	$ **0.44**
Weighted average diluted shares outstanding	25,999	25,701
Dividends declared per share	$ **0.090**	$ **0.090**

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)

	Nine months ended	
	September 29, 2012 (unaudited)	October 1, 2011 (unaudited)
Net sales	**$ 161,131**	**$ 158,514**
Cost of sales	96,546	96,147
Gross profit	**64,585**	**62,367**
Selling, engineering and administrative expenses	19,662	17,570
Operating income	**44,923**	**44,797**
Interest income, net	(1,041)	(590)
Foreign currency transaction gain, net	(75)	(36)
Miscellaneous income, net	(158)	(1,550)
Income before income taxes	**46,197**	**46,973**
Income tax provision	15,493	15,369
Net income	**$ 30,704**	**$ 31,604**
Basic net income per common share	**$ 1.19**	**$ 1.23**
Weighted average basic shares outstanding	25,904	25,613
Diluted net income per common share	**$ 1.18**	**$ 1.23**
Weighted average diluted shares outstanding	25,937	25,653
Dividends declared per share	**$ 0.390**	**$ 0.313**

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 Comprehensive Income (Loss)

(in thousands)

	Three months ended		Nine months ended	
	September 29, 2012 (unaudited)	October 1, 2011 (unaudited)	September 29, 2012 (unaudited)	October 1, 2011 (unaudited)
Net income	$ 8,835	$ 11,394	$ 30,704	$ 31,604
Other comprehensive income (loss)				
Foreign currency translation adjustments	1,364	(2,964)	1,032	(657)
Unrealized gain (loss) on available-for-sale securities	200	(517)	317	(532)
Total other comprehensive income (loss)	1,564	(3,481)	1,349	(1,189)
Comprehensive income	$ 10,399	$ 7,913	$ 32,053	$ 30,415

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

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Sun Hydraulics Corporation

Consolidated Statement of Changes in Shareholders' Equity (unaudited)

(in thousands)

	Preferred shares	Preferred stock	Common shares	Common stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income	Total
Balance, December 31, 2011	—	$ —	25,756	$ 26	$48,944	$ 98,426	$ (2,120)	$145,276
Shares issued, other comp			53					—
Shares issued, ESPP			38		506			506
Shares issued, shared distribution			145		4,407			4,407
Stock-based compensation					2,569			2,569
Dividends declared						(10,128)		(10,128)
Net income						30,704		30,704
Other comprehensive income							1,349	1,349
Balance, September 29, 2012	—	$ —	25,992	$ 26	$56,426	$119,002	$ (771)	$174,683

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

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Sun Hydraulics Corporation

Consolidated Statements of Cash Flows

(in thousands)

	Nine months ended	
	September 29, 2012 (unaudited)	October 1, 2011 (unaudited)
Cash flows from operating activities:		
Net income	$ 30,704	$ 31,604
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,353	5,025
Gain on investment in HCT	—	(1,244)
(Gain)Loss on disposal of assets	84	(27)
Provision for deferred income taxes	4	—
Allowance for doubtful accounts	44	16
Stock-based compensation expense	1,639	1,218
(Increase) decrease in, net of acquisition:		
Accounts receivable	(2,309)	(2,927)
Inventories	(147)	(823)
Income taxes receivable	120	866
Other current assets	86	(488)
Other assets	(92)	(88)
Increase (decrease) in, net of acquisition:		
Accounts payable	65	1,534
Accrued expenses and other liabilities	3,722	3,535
Income taxes payable	1,047	—
Other noncurrent liabilities	(219)	(202)
Net cash provided by operating activities	40,101	37,999
Cash flows from investing activities:		
Proceeds from sale of joint venture	—	1,451
Acquisition of business, net of cash acquired	—	(1,776)
Capital expenditures	(6,703)	(6,778)
Proceeds from dispositions	56	30
Purchases of marketable securities	(25,774)	(13,516)
Proceeds from sale of marketable securities	6,821	6,497
Net cash used in investing activities	(25,600)	(14,092)
Cash flows from financing activities:		
Proceeds from exercise of stock options	—	61
Proceeds from stock issued	506	408
Dividends to shareholders	(10,107)	(7,284)
Net cash used in financing activities	(9,601)	(6,815)
Effect of exchange rate changes on cash and cash equivalents	762	(707)
Net increase in cash and cash equivalents	5,662	16,385
Cash and cash equivalents, beginning of period	**45,080**	**33,206**
Cash and cash equivalents, end of period	**$ 50,742**	**$ 49,591**
Supplemental disclosure of cash flow information:		
Cash paid:		
Income taxes	$ 14,323	$ 14,503
Supplemental disclosure of noncash transactions:		
Common stock issued for shared distribution through accrued expenses and other liabilities	$ 4,407	$ 2,412
Common stock issued for deferred director's compensation through other noncurrent liabilities	$ 930	$ —

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

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

1. BASIS OF PRESENTATION AND SUMMARY OF 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, Korea, France, China, and India. Sun Hydraulics Corporation (“Sun Hydraulics”), with its main offices located in Sarasota, Florida, designs, manufactures, and sells its products 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, was dissolved in November 2011. Concurrently, Sun Hydraulics opened a liaison office in France to service this market. Sun Hydraulics established Sun Hydraulics China Co. Ltd, a representative office in Shanghai in January 2011, to develop new business opportunities in the Chinese market. Sun Hydraulics (India) a liaison office in Bangalore, India is used to develop new business opportunities in the Indian market. WhiteOak Controls, Inc. (“WhiteOak”), a 40% equity method investment, located in Mediapolis, Iowa, designs and produces complementary electronic control products. On September 27, 2011, Sun Hydraulics purchased the outstanding shares of High Country Tek, Inc. (“HCT”) it did not already own. HCT, now a wholly-owned subsidiary of Sun Hydraulics, is located in Nevada City, California, and designs and manufactures ruggedized electronic/hydraulic control solutions for mobile equipment markets.

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 31, 2011, filed by Sun Hydraulics Corporation (together with its subsidiaries, the “Company”) with the Securities and Exchange Commission on March 14, 2012. 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 and nine month periods ended September 29, 2012, are not necessarily indicative of the results that may be expected for the period ending December 29, 2012.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Earnings per share

The following table represents the computation of basic and diluted earnings per common share (in thousands, except per share data):

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Net income	**$ 8,835**	**$ 11,394**	**$ 30,704**	**$ 31,604**
Weighted average basic shares outstanding	25,989	25,652	25,904	25,613
Basic net income per common share	**$ 0.34**	**$ 0.44**	**$ 1.19**	**$ 1.23**
Effect of dilutive stock options	10	49	32	40
Weighted average diluted shares outstanding	25,999	25,701	25,937	25,653
Diluted net income per common share	**$ 0.34**	**$ 0.44**	**$ 1.18**	**$ 1.23**

Reclassification

Certificates of deposit classified as cash in the prior period were reclassified to marketable securities to conform to the current year presentation.

3. STOCK-BASED COMPENSATION

The Company's 2006 Stock Option Plan ("2006 Plan") provides for the grant of incentive stock options and nonqualified stock options for the purchase of up to an aggregate of 1,125,000 shares of the Company's common stock by officers, employees and directors of the Company. Under the terms of the plan, incentive stock options may be granted to employees at an exercise price per share of not less than the fair value per common share on the date of the grant (not less than 110% of the fair value in the case of holders of more than 10% of the Company's voting stock). Nonqualified stock options may be granted at the discretion of the Company's Board of Directors. The maximum term of an option may not exceed 10 years, and options become exercisable at such times and in such installments as determined by the Board of Directors. No awards have been granted under the 2006 Plan.

The Company's 2001 Restricted Stock Plan provides for the grant of restricted stock of up to an aggregate of 928,125 shares of the Company's common stock to officers, employees, consultants and directors of the Company. Under the terms of the plan, the minimum period before any shares become non-forfeitable may not be less than six months. The 2001 Restricted Stock Plan expired in 2011 and was replaced in September 2011 with the 2011 Equity Incentive Plan ("2011 Plan"). The 2011 Plan provides for the grant of up to an aggregate of 1,000,000 shares of restricted stock, restricted share units, stock appreciation rights, dividend or dividend equivalent rights, stock awards and other awards valued in whole or in part by reference to or otherwise based on the Company's common stock, to officers, employees and directors of the Company. The 2011 Plan was approved by the Company's shareholders at the 2012 Annual Meeting. At September 29, 2012, 912,462 shares remained available to be issued through the 2011 Plan. Compensation cost is measured at the date of the grant and is recognized in earnings over the period in which the shares vest. Restricted stock expense for the nine months ended September 29, 2012, and October 1, 2011, totaled $1,176 and $776 respectively.

The following table summarizes restricted stock activity from December 31, 2011, through September 29, 2012:

	Number of shares	Weighted average grant-date fair value
Nonvested balance at December 31, 2011	154	24.25
Granted	—	—
Vested	—	—
Forfeitures	(2)	—
Nonvested balance at September 29, 2012	152	24.23

The Company has $1,925 of total unrecognized compensation cost related to restricted stock awards granted under the two plans as of September 29, 2012. That cost is expected to be recognized over a weighted average period of 1.05 years.

The Company maintains an Employee Stock Purchase Plan ("ESPP"), in which most employees are eligible to participate. Employees in the United States who choose to participate are granted an opportunity to purchase common stock at 85 percent of market value on the first or last day of the quarterly purchase period, whichever is lower. Employees in the United Kingdom, under a separate plan, are granted an opportunity to purchase common stock at market value, on the first or last day of the quarterly purchase period, whichever is lower, with the Company issuing one additional free share of common stock for each six shares purchased by the employee under the ESPP. The ESPP authorizes the issuance, and the purchase by employees, of up to 1,096,875 shares of common stock through payroll deductions. No U.S. employee is allowed to buy more than $25 of common stock in any year, based on the market value of the common stock at the beginning of the purchase period, and no U.K. employee is allowed to buy more than the lesser of £1.5 or 10% of his or her annual salary in any year. Employees purchased 25,882 shares at a weighted average price of $19.55, and 19,550 shares at a weighted average price of $20.86, under the ESPP during the nine months ended September 29, 2012, and October 1, 2011, respectively. The Company recognized $129 and $135 of compensation expense during the nine months ended September 29, 2012, and October 1, 2011, respectively. At September 29, 2012, 722,666 shares remained available to be issued through the ESPP and the U.K. plan.

The Nonemployee Director Equity and Deferred Compensation Plan (the "Plan") originally was adopted by the Board of Directors and approved by the shareholders in 2004, and amended in 2008. Under the Plan, Directors who were not officers of the Company were paid 375 shares of Company common stock and $3 in cash fees for attendance at each meeting of the Board of Directors, as well as each meeting of each Board Committee on which they served when the committee meeting was not held within one day of a meeting of the Board of Directors. Committee Chairmen received additional fees equal to 25% of normal compensation and the Chairman of the Board was paid twice the amount of normal compensation, with such additional compensation payable in Company common stock. The Plan authorized the issuance of up to 270,000 shares of common stock. At September 29, 2012, 179,375 shares remained available to be issued through the Plan.

Prior to June 7, 2011, Directors were able to elect under the Plan to receive all or part of their cash fees in Company stock and to defer receipt of their fees until a subsequent year. When so deferred, the shares of stock were converted to deferred stock units. Deferred stock units are treated as liabilities. At September 29, 2012, there were 10,090 deferred stock units outstanding.

In March 2012, the Board reviewed its non-employee director compensation policy and determined that compensating Directors solely in Company stock would further align the interests of the Board and the shareholders. Accordingly, the Board of Directors adopted the Sun Hydraulics Corporation 2012 Nonemployee Director Fees Plan (the "2012 Directors Plan"), which was approved by the shareholders of the Company at its 2012 annual meeting.

Under the 2012 Directors Plan, as compensation for attendance at each Board meeting and each meeting of each committee of the Board on which he or she serves when the committee meeting is not held within one day of a meeting of the Board, each Nonemployee Director will be paid 500 shares of Common Stock. The Chairman's fee is twice that of a regular director, and the fee for the chairs of each Board committee is 125% that of a regular director. The Board has the authority to change from time to time, in any manner it deems desirable or appropriate, the share compensation to be awarded to all or any one or more Nonemployee Directors, provided that, with limited exceptions, such changes are subject to prior shareholder approval. The aggregate number of Shares which may be issued during any single calendar year is limited to 25,000 Shares. The 2012 Directors Plan authorizes the issuance of up to 270,000 shares of common stock. At September 29, 2012, 261,249 shares remained available to be issued through the 2012 Directors Plan.

Directors were granted 12,676 and 11,207 shares for the nine months ended September 29, 2012, and October 1, 2011, respectively. The Company recognized director stock compensation expense of $349 and $30 for the nine months ended September 29, 2012, and October 1, 2011, respectively.

4. RESTRICTED CASH

The restricted cash balance at September 29, 2012, consisted of $49 in reserves as a required deferment for customs in the U.K. operation. The restricted amount was calculated as an estimate of two months of customs for items coming into the Company's U.K. operation and is held with Lloyds TSB in the U.K.

5. INVENTORIES

	September 29, 2012	December 31, 2011
Raw materials	$ 6,483	$ 5,624
Work in process	3,794	3,912
Finished goods	3,363	3,861
Provision for slow moving inventory	(664)	(568)
Total	$ 12,976	$ 12,829

6. GOODWILL AND INTANGIBLE ASSETS

The Company had $2,691 of goodwill at September 29, 2012, and December 31, 2011, including $715 related to its acquisition of Sun Korea and $1,976 related to the acquisition of HCT. Goodwill is held in other assets on the balance sheet.

The goodwill related to the acquisition of Sun Korea of $715 was valued at December 31, 2011, using a valuation model reflecting the expected future cash flow projections. The analysis indicated that there was no impairment of the carrying value of the goodwill. As of September 29, 2012, no factors were identified that indicated impairment of the carrying value of the goodwill related to Sun Korea.

On September 27, 2011, the Company recognized goodwill arising from the acquisition of HCT equal to $1,976 consisting of the value of the workforce, synergies and competitive advantages obtained as a result of the acquisition. The goodwill was valued during the period ended September 29, 2012, using a valuation model reflecting the expected future cash flow projections. The analysis indicated that there was no impairment of the carrying value of the goodwill.

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The Company recognized $2,658 in identifiable intangible assets as a result of its acquisitions of HCT. Intangible assets are held in other assets on the balance sheet. At September 29, 2012, and December 31, 2011, intangible assets consisted of the following:

		September 29, 2012			December 31, 2011		
	Useful life (years)	Gross carrying amount	Accumulated amortization	Net carrying amount	Gross carrying amount	Accumulated amortization	Net carrying amount
Definite-lived intangibles:							
Trade Name	10	$ 756	$ (76)	$ 680	$ 756	$ (19)	$ 737
Technology	10	697	(239)	458	697	(187)	510
Customer Relationships	20	1,475	(74)	1,401	1,475	(18)	1,457
		$ 2,928	$ (389)	$ 2,539	$ 2,928	$ (224)	$ 2,704

Total estimated amortization expense for the years 2012 through 2016 is presented below. The amount reflected below for 2012 includes year-to-date amortization expense.

Year:	
2012	219
2013	219
2014	219
2015	206
2016	192
Total	$1,055

Intangible assets are evaluated for impairment whenever events or circumstances indicate that the undiscounted net cash flows to be generated by their use over their expected useful lives and eventual disposition may be less than their net carrying value. No such events or circumstances occurred during the nine months ended September 29, 2012.

7. INVESTMENTS

On January 5, 2011, Sun Hydraulics completed the sale of its Chinese joint venture company, Sun Hydraulics Systems (Shanghai) Co, Ltd., to the joint venture partner, Links Lin, for the amount of $1,451, and recognized a gain on the sale of $366, which is included in miscellaneous income on the consolidated statement of operations. The former joint venture company has become Sun's first authorized distributor in China. Concurrently, Sun established Sun Hydraulics China Co. Ltd, a representative office in Shanghai which now is the Company's primary operation in the country.

8. ACQUISITIONS

On September 27, 2011, Sun purchased the remaining preferred and common shares of HCT that it did not already own. HCT designs and produces encapsulated, modular, highly ruggedized digital and analog electronic controller products for the global fluid power and motion control industry. HCT's products complement Sun's electro-hydraulic line of valves providing reliable, easy, simple and accurate control of individual valves, or seamless management of systems and sub-systems.

The acquisition was accounted for as a business combination using the acquisition method and, accordingly, the identifiable assets acquired and the liabilities assumed were recorded at their estimated fair value at the date of acquisition.

The revenue and earnings for HCT included in Sun's Consolidated Statement of Operations for the nine months ended September 29, 2012, and the revenue and earnings of the combined entities had the acquisition date been January 2, 2011, are included in the table below.

	Revenue (unaudited)	Earnings (unaudited)
Actual from 01/01/2012 – 09/29/2012	$ 2,836	$ (404)
Supplemental *pro forma* from 01/02/2011 to 10/01/2011	$161,311	$ 31,728

9. LONG-TERM DEBT

Effective August 1, 2011, the Company completed a credit and security agreement in the U.S. with Fifth Third Bank (the “Bank”). The agreement provides for three separate credit facilities totaling $50,000.

Facility A is a $15,000 unsecured revolving line of credit and requires monthly payments of interest. Facility A has a floating interest rate of 1.45% over the 30-day LIBOR Rate (as defined).

Facility B is an accordion feature to increase the revolving line of credit to a $35,000 secured revolving line of credit. Facility B will be secured by the Company’s U.S. assets, including its manufacturing facilities, and requires monthly payments of interest. Facility B will bear interest at the 30-day LIBOR Rate or the Bank’s Base Rate (as defined), at the Company’s discretion, plus a margin based on the Borrower’s Funded Debt to EBITDA Leverage Ratio (as defined). The LIBOR Margin ranges from 1.45% to 2.25% and the Bank’s Base Rate ranges from -0.25% to 0.00%.

Facility C is a $15,000 construction and term loan. Facility C requires monthly payments of interest for the first 24 months and monthly payments of principal plus accrued interest for 60 months based upon a 15 year amortization schedule. The Construction Loan bears interest at the 30-day LIBOR Rate or the Bank’s Base Rate, at the Company’s discretion, plus a margin based on the Borrower’s Funded Debt to EBITDA Leverage Ratio. The LIBOR Margin ranges from 1.65% to 2.45% and the Bank’s Base Rate ranges from -0.05% to 0.20%.

Facility A or Facility B (if activated) is payable in full on August 1, 2016. Facility C is payable seven years after the closing of the facility. Maturity may be accelerated by the Bank upon an Event of Default (as defined). Prepayment may be made without penalty or premium at any time upon the required notice to the Bank.

Facility A is subject to debt covenants (capitalized terms are defined therein) including: 1) Minimum Tangible Net Worth of not less than $92,000, increased annually by 50% of Net Income, and 2) Minimum EBITDA of not less than $5,000; and requires the Company to maintain its primary domestic deposit accounts with the bank.

If Facility B or Facility C are activated, covenant 2 above will automatically terminate and two additional covenants will be required: 1) Funded Debt to EBITDA ratio equal to or less than 3.0:1.0, and 2) EBIT to Interest Expense ratio of not less than 2.5:1.0.

10. INCOME TAXES

At September 29, 2012, the Company had an unrecognized tax benefit of $995 including accrued interest, an increase of $692 from the prior period for uncertain tax positions related to previous years. If recognized, the unrecognized tax benefit would have a favorable effect on the effective tax rate in future periods. The Company recognizes interest and penalties related to income tax matters in income tax expense. Interest accrued as of September 29, 2012, is not considered material to the Company’s consolidated financial statements.

The Company files U.S. federal income tax returns as well as income tax returns in various states and foreign jurisdictions. The Company is no longer subject to income tax examinations by tax authorities for years prior to 2004 for the majority of tax jurisdictions.

The Company's federal returns are currently under examination by the Internal Revenue Service (IRS) in the United States for the periods 2004 through 2009. To date, there have not been any significant proposed adjustments that have not been accounted for in the Company's consolidated financial statements.

Audit outcomes and the timing of audit settlements are subject to significant uncertainty. It is reasonably possible that within the next twelve months the Company will resolve some or all of the matters presently under consideration for 2004 through 2009 with the IRS and that there could be significant increases or decreases to unrecognized tax benefits.

11. 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. Operations in France were conducted through a subsidiary of the Company until its dissolution in November 2011, at which time it became a liaison office. Amounts for France, due to their immateriality, are included with the U.S. Additionally, costs associated with the Company's representative office in China and liaison office in India are included as part of the U.S. operating segment, as are sales into these regions. 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 September 29, 2012						
Sales to unaffiliated customers	$ 34,302	$ 3,495	$ 6,267	$ 4,761	$ —	$ 48,825
Intercompany sales	7,331	—	31	443	(7,805)	—
Operating income	11,069	185	1,296	912	(267)	13,195
Depreciation	1,302	36	82	185	—	1,605
Capital expenditures	1,735	4	6	206	—	1,951
Three Months Ended October 1, 2011						
Sales to unaffiliated customers	$ 34,897	$ 5,081	$ 7,824	$ 5,239	$ —	$ 53,041
Intercompany sales	8,763	—	60	405	(9,228)	—
Operating income	12,119	575	2,028	892	(115)	15,499
Depreciation	1,294	28	85	235	—	1,642
Capital expenditures	4,121	89	7	68	—	4,285
Nine Months Ended September 29, 2012						
Sales to unaffiliated customers	$109,381	$14,401	$20,741	$16,608	$ —	$ 161,131
Intercompany sales	24,872	—	75	1,289	(26,236)	—
Operating income	35,966	1,400	4,488	3,131	(62)	44,923
Depreciation	3,933	93	242	622	—	4,890
Capital expenditures	5,949	24	38	692	—	6,703
Nine Months Ended October 1, 2011						
Sales to unaffiliated customers	$100,515	$16,778	$22,320	$18,901	$ —	$ 158,514
Intercompany sales	26,722	—	176	1,188	(28,086)	—
Operating income	33,481	2,175	5,690	3,379	72	44,797
Depreciation	3,879	83	272	721	—	4,955
Capital expenditures	6,631	234	57	173	—	7,095

Sales to unaffiliated customers represent sales from each of the individual subsidiaries. For information on sales to geographic locations, see the Comparison of the Nine Month Periods Ended September 29, 2012, and October 1, 2011, in Management’s Discussion and Analysis of Financial Condition and Results of Operations. Operating income is total sales and other operating income less operating expenses. Segment operating income does not include interest income/expense, foreign currency transaction gain/loss, and net miscellaneous income/expense.

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company uses the three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

Level 1. Observable inputs such as quoted prices in active markets;

Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The Company held available-for-sale securities with an aggregate fair value of $40,502 and $21,832 at September 29, 2012, and December 31, 2011, respectively. The Company, on a recurring basis, measures available-for-sale securities at fair value using quoted prices in active markets. The net unrealized holding loss amounted to $175 and $492 at September 29, 2012, and December 31, 2011, respectively. In addition, the Company reports deferred director stock units and phantom stock units as a liability. These liabilities, on a recurring basis, are measured at fair value using quoted prices in the active market. The Company's liability was $338 and $1,182, at September 29, 2012, and December 31, 2011, respectively. The Company recognized expense related to those liabilities of $74 and a gain of $194 for the nine month periods ended September 29, 2012, and October 1, 2011, respectively.

The Company did not have any fair value adjustments for assets and liabilities measured at fair value on a nonrecurring basis during the nine months ended September 29, 2012, and October 1, 2011.

Assets measured at fair value on a recurring basis include the following at September 29, 2012:

		Fair Value Measurements at the End of the Reporting Period Using		
Description	September 29, 2012	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities	$ 40,502	$ 40,502	$ —	$ —

Liabilities measured at fair value on a recurring basis include the following at September 29, 2012:

		Fair Value Measurements at the End of the Reporting Period Using		
Description	September 29, 2012	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Deferred director stock units	$ 268	$ 268	$ —	$ —
Phantom stock units	70	70	—	—
Total recurring fair value measurements	$ 338	$ 338	$ —	$ —

The carrying amounts of cash and cash equivalents, restricted cash, accounts receivable, other current assets, accounts payable, accrued expenses and other liabilities approximate fair value based on their short-term status.

13. NEW ACCOUNTING PRONOUNCEMENTS

In June 2011, the FASB issued guidance amending the presentation of comprehensive income. This amends existing guidance by allowing only two options for presenting the components of net income and other comprehensive income: (1) in a single continuous financial statement, statement of comprehensive income or (2) in two separate but consecutive financial statements, consisting of an income statement followed by a separate statement of other comprehensive income. Also, items that are reclassified from other comprehensive income to net income must be presented on the face of the financial statements. The guidance requires retrospective application, and it is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. In December 2011, the FASB issued another amendment to defer certain requirements from the June 2011 guidance that relate to the presentation of reclassification adjustments. The amendments will allow the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. The Company adopted the requirements effective for the Company's first quarter 2012. There was no material impact as a result of this. We are in the process of evaluating the disclosure impact of the deferred requirements within this guidance.

In September 2011, the FASB amended the guidance on the annual testing of goodwill for impairment. The amended guidance will allow companies to assess qualitative factors to determine if it is more-likely-than-not that goodwill might be impaired and whether it is necessary to perform the two-step goodwill impairment test required under current accounting standards. This guidance will be effective for the Company's fiscal year ending December 29, 2012, with early adoption permitted. The Company has determined that this new guidance will not have a material impact on its consolidated financial statements.

In July 2012, the FASB amended guidance on the annual testing of indefinite-lived intangible assets for impairment. Under the amended guidance, an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. This guidance will be effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The Company has determined that this new guidance will not have a material impact on its consolidated financial statements.

14. 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.

15. SUBSEQUENT EVENT

On October 18, 2012, the Company, through Sun Korea, purchased all of the outstanding stock of Seungwon Solutions Corporation ("Seungwon") for approximately $1,373. Seungwon is a component supplier to Sun Korea, which represents approximately 80% of Seungwon's sales. The Company has not completed the initial accounting for the business combination, but does not expect the acquisition to have a material impact on its consolidated financial statements.

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 subsidiaries and independent distributors. Sales outside the United States for the year ended December 31, 2011, were approximately 60% of total net sales.

Approximately two-thirds 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 the mobile market include equipment used in off-road construction, agriculture, fire and rescue, utilities, oil fields, and mining.

The remaining one-third 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. Power units, 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 increased 24% and 42% in 2011 and 2010, respectively, after a decrease of 40% in 2009. The index of shipments of hydraulic products decreased 1% for the three-month period ending September 29, 2012, compared to the same period of the prior year.

The Company's order trend has historically tracked closely to the United States Purchasing Managers Index (PMI). When PMI is over 50, it indicates economic expansion in the manufacturing sector; when it is below 50, it indicates contraction. The index decreased to 51.5 in September 2012 compared to 52.5 in September 2011. In October 2012, the index was 51.7. This is the second consecutive month of expansion following three months of slight contraction.

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Results for the third quarter
(in millions except net income per share)

	September 29, 2012	October 1, 2011	Increase/Decrease
Three Months Ended			
Net sales	$ 48.8	$ 53.0	-8%
Net income	$ 8.8	$ 11.4	-23%
Net income per share:			
Basic	$ 0.34	$ 0.44	-23%
Diluted	$ 0.34	$ 0.44	-23%
Nine Months Ended			
Net sales	$ 161.1	$ 158.5	2%
Net income	$ 30.7	$ 31.6	-3%
Net income per share:			
Basic	$ 1.19	$ 1.23	-3%
Fully Diluted	$ 1.18	$ 1.23	-4%

Third quarter sales were as management expected. The sales decline was driven primarily by Asia/Pacific and Europe. While business was down in these regions, the Company continued to gain new customers to make up for slowing business with existing customers. North America was able to eke out a modest increase in the period. Earnings were within the Company's forecast range, despite being negatively impacted by approximately $0.01 due to taxes.

The Company's product development efforts are ongoing and new products continue to represent between 10 and 15% of sales. The Company has also been working to revamp and enhance its website and expects to launch the new version in early 2013. The new website will be faster, with added configuration mechanisms to make it easier for customers to define and procure solutions.

The fourth quarter forecast reflects continued sluggishness in the macro economy. The PMI is bouncing around the 50 mark, plus or minus, and has yet to provide any clear trend indications either positive or negative. Despite global headwinds, management believes 2012 will be a successful year for Sun. The Company's efforts remain focused on product and market development and providing differentiated solutions and services to its customers.

Outlook

Fourth quarter 2012 revenues are expected to be approximately $41 million, down approximately 10% from the fourth quarter of 2011. Earnings per share are estimated to be $0.22 to $0.24 compared to $0.24 in the same period a year ago.

Management estimates year-end 2012 sales to be approximately $202 million, down approximately 1% from 2011 sales. Earnings per share for 2012 are estimated to be $1.40 to $1.42, compared to $1.46 in 2011.

For comparison purposes, 2011 results included a one-time $0.03 per share gain resulting from the acquisition of HCT.

COMPARISON OF THE THREE MONTHS ENDED SEPTEMBER 29, 2012 AND OCTOBER 1, 2011

Net Sales

Net sales were $48.8 million, a decrease of $4.2 million, or 7.9%, compared to $53.0 million in 2011. The decrease in net sales was primarily driven by weaker demand in our European and Asian end markets, which primarily include capital goods equipment. A price increase, effective July 1, 2012, contributed approximately 3%, or $1.4 million to sales. Changes in exchange rates had a negative impact on sales of approximately 2%, or $0.9 million. New product sales (defined as products introduced within the last five years) continue to make up 10 – 15% of total sales.

North American sales increased 2.4% or $0.6 million, to $25.9 million, Asian sales were down 23.0%, or $2.1 million, to $7.0 million, and European sales were down 17.0%, or $2.8 million, to $13.6 million.

The U.S. reporting segment had sales of $34.3 million in the third quarter of 2012, down $0.6 million or 1.7%, compared to sales of $34.9 million during the third quarter last year. The decrease was driven by weaker demand in all geographic end markets. International sales out of the U.S. were $11.9 million during the third quarter of 2012, down 6.3% or $0.8 million, compared to $12.7 million during the third quarter last year. The decrease in international sales was primarily caused by decreased sales to Europe and Asia.

The Korean reporting segment had sales of $3.5 million during the third quarter of 2012, down $1.6 million or 31.2%, compared to sales of $5.1 million during the third quarter last year. Currency effect had a negative impact of approximately $0.2 million on Korea’s third quarter 2012 sales. The remainder of the decrease related to reduced demand within Korea and China.

The German reporting segment had sales of $6.3 million during the third quarter of 2012, down $1.6 million or 19.9%, compared to sales of $7.8 million during the third quarter last year. Currency translation effect due to a weakening Euro had a negative impact on third quarter sales of approximately $0.7 million. The remainder of the decrease primarily related to sales within Germany and to Italy.

The U.K. reporting segment had sales of $4.8 million during the third quarter of 2012, down $0.5 million or 9.1%, compared to sales of $5.2 million during the third quarter last year. The decrease in sales was primarily related to sales to France. Currency effect had a negative impact of approximately $0.1 million on U.K.’s third quarter 2012 sales.

Gross Profit

Gross profit decreased $1.4 million or 6.5% to $19.4 million in the third quarter of 2012, compared to $20.7 million in the third quarter last year. Gross profit as a percentage of net sales increased to 39.7% in the third quarter of 2012, compared to 39.1% in the third quarter last year.

Lower sales volume reduced gross profit by approximately $2.2 million. The remainder of the decrease resulted from higher material costs of approximately $0.6 million, and fixed overhead costs as a percent of sales of $0.5 million. These amounts were partially offset by a price increase in July 2012 of approximately $1.4 million, and reduced variable overhead costs as a percent of sales of $0.7 million, primarily related to reduced overtime and retirement benefit costs.

Selling, Engineering and Administrative Expenses

Selling, engineering and administrative expenses increased 18.2%, or $1.0 million, to $6.2 million in 2012, compared to $5.2 million last year. The change for the third quarter of 2012 was primarily due to increased compensation costs of approximately $0.7 resulting from variable compensation to directors, and expenses at HCT of approximately $0.4 million, which were included in the current year. This is the last quarter where HCT’s SEA expense will affect year over year comparisons.

Operating Income

Operating income decreased $2.3 million or 14.9% to $13.2 million in the third quarter of 2012, compared to $15.5 million in the third quarter last year, with operating margins of 27.0% and 29.2% for the third quarters of 2012 and 2011, respectively.

The U.S. reporting segment contributed $11.1 million to our consolidated operating income during the third quarter of 2012, compared to $12.1 million during the third quarter of 2011. The decrease of $1.1 million in the U.S. operating segment was primarily related to our fixed cost base. This was partially offset by gains in direct labor and variable overhead.

The Korean reporting segment contributed $0.2 million to our consolidated operating income during the third quarter of 2012 compared to $0.6 million during the third quarter last year. The decrease in operating margins was primarily related to lower sales, fixed costs, and increased material costs.

The German reporting segment contributed $1.3 million to our consolidated operating income during the third quarter of 2012 compared to $2.0 million during the third quarter last year. The decrease in operating margins was primarily related to sales volume and increased material costs. Material cost increases were related to purchases of material in U.S. Dollars and a weakening Euro.

The U.K. reporting segment contributed $0.9 million to our consolidated operating income during the third quarters of 2012 and 2011. Operating income decreases from lower sales volume were offset by decreases in material and variable overhead costs.

Interest Income, Net

Net interest income was $0.4 million for the quarter ended September 29, 2012, compared to $0.2 million for the quarter ended October 1, 2011. The Company currently has no outstanding debt. Total average cash and investments for the quarter ended September 29, 2012, was $87.8 million compared to $65.3 million for the quarter ended October 1, 2011.

Miscellaneous Income/Expense, Net

There was minimal net miscellaneous expense for the quarter ended September 29, 2012, compared to net miscellaneous income of $1.3 for the quarter ended October 1, 2011. The prior period amount includes a gain of $1.2 million as a result of remeasuring to fair value the Company’s 38% equity interest in HCT held before the business combination.

Income Taxes

The provision for income taxes for the quarter ended September 29, 2012, was 35.0% of pretax income compared to 32.9% for the quarter ended October 1, 2011. For the current period, taxes include discrete items of approximately 1.5% of pretax income related to reserves for uncertain tax positions, which were partially offset by provision to return true-ups. The remaining change relates to the relative levels of income and different tax rates in effect among the countries in which the Company sells its products.

COMPARISON OF THE NINE MONTHS ENDED SEPTEMBER 29, 2012 AND OCTOBER 1, 2011

Net Sales

Net sales were $161.1 million, an increase of $2.6 million, or 1.7%, compared to $158.5 million in 2011. The increase in net sales was primarily driven by increased demand in North America in our end markets, which primarily include capital goods equipment. Price increases, effective July 1, 2011, and July 1, 2012, contributed approximately 3%, or $5.0 million to sales. Changes in exchange rates had a negative impact on sales of approximately 1.5%, or $2.3 million. New product sales (defined as products introduced within the last five years) continue to make up 10 – 15% of total sales.

North American sales increased 13.2% or $9.4 million, to $80.7 million, Asian sales were down 9.6%, or $3.0 million, to $28.3 million, and European sales were down 8.0%, or $4.0 million, to $46.2 million.

The U.S. reporting segment had sales of $109.4 million in 2012, up $8.9 million or 8.8%, compared to sales of $100.5 million last year. The increase was driven primarily by demand in North American end markets. HCT, acquired in the fourth quarter of 2011, added $2.7 million to sales in 2012. International sales out of the U.S. were $39.6 million in 2012, up 1.2% or $0.5 million, compared to $38.4 million last year. The increase in sales was primarily caused by increased sales to Canada. Sales from the U.S. to Europe remained relatively flat, while sales to Asia decreased from the prior year.

The Korean reporting segment had sales of $14.4 million in 2012, down $2.4 million or 14.2%, compared to sales of $16.8 million last year. Currency effect had a negative impact of approximately $0.6 million on Korea's 2012 sales. The remainder of the decrease related to reduced demand within Korea and China.

The German reporting segment had sales of $20.7 million in 2012 down $1.6 million or 7.1%, compared to sales of $22.3 million in 2011. Sales increased slightly in local currency compared to the prior year, but currency translation effect due to a weakening Euro had a negative impact on 2012 sales of approximately $1.6 million.

The U.K. reporting segment had sales of $16.6 million in 2012, down $2.3 million or 12.1%, compared to sales of $18.9 million last year. The decrease in sales was primarily related to reduced demand relating to a onetime project in the U.K. last year, which contributed approximately $2.0 million to sales in 2011 that did not occur during the current period. There was a negative impact from currency on the U.K.'s 2012 sales of $0.2 million.

Gross Profit

Gross profit increased $2.2 million or 3.6% to $64.6 million in 2012, compared to $62.4 million last year. Gross profit as a percentage of net sales increased to 40.1% in 2012, compared to 39.3% last year.

The increase in gross profit was primarily attributed to price increases in July 2011 and 2012, totaling approximately $5.0 million, and decreases in variable overhead costs as a percent of sales primarily related to reduced overtime and retirement benefits. These amounts were partially offset by increased material costs of $1.8 million, labor costs of $0.3 million, fixed overhead costs as a percent of sales of $0.8 million. Additionally, sales volume, excluding pricing, reduced gross profit approximately $0.9 million.

Selling, Engineering and Administrative Expenses

Selling, engineering and administrative expenses increased 11.9%, or $2.1 million, to $19.7 million in 2012, compared to $17.6 million last year. The change for 2012 was primarily due to expenses at HCT of approximately $1.3 million, which were included in the current year, increased compensation costs of $0.8 million, which includes variable director compensation.

Operating Income

Operating income increased $0.1 million or 0.3% to $44.9 million in 2012, compared to $44.8 million last year, with operating margins of 27.9% and 28.3% for 2012 and 2011, respectively.

The U.S. reporting segment contributed $36.0 million to our consolidated operating income during 2012, compared to $33.5 million during 2011. The increase of $2.5 million in the U.S. operating segment was primarily related to the increase in sales volume.

The Korean reporting segment contributed $1.4 million to our consolidated operating income during 2012 compared to $2.2 million last year. The decrease in operating margins was primarily related to reduced sales volume and increased material costs.

The German reporting segment contributed $4.5 million to our consolidated operating income during 2012 compared to $5.7 million last year. The decrease in operating margins was primarily related to increased material costs. Material cost increases were related to purchases of material in U.S. Dollars and a weakening Euro.

The U.K. reporting segment contributed $3.1 million to our consolidated operating income during 2012 compared to $3.4 million last year. The decrease in operating income was primarily related to the decrease in sales volume.

Interest Income, Net

Net interest income was $1.0 million in 2012, compared to $0.6 million in 2011. The Company currently has no outstanding debt. Total average cash and investments for the nine months ended September 29, 2012, was $82.2 million compared to $56.4 million for the nine months ended October 1, 2011.

Miscellaneous Income, Net

There was net miscellaneous income of $0.2 million in 2012, compared to net miscellaneous income of $1.6 million in 2011. The current period income is primarily related to an incentive received for our thermal storage energy building. The prior period includes a gain of $1.2 million as a result of remeasuring to fair value the Company’s 38% equity interest in HCT held before the business combination. The prior period also includes the gain recognized on the sale of our China joint venture.

Income Taxes

The provision for income taxes for the nine months ended September 29, 2012, was 33.5% of pretax income compared to 32.7% for the nine months ended October 1, 2011. The change was primarily due to the relative levels of income and different tax rates in effect among the countries in which the Company sells its products. For the current year, taxes include discrete items of approximately 0.5% of pretax income related to reserves for uncertain tax positions, which were partially offset by provision to return true-ups.

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, repurchase Company common stock and service debt.

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Cash from operations for the nine months ended September 29, 2012, was $40.1 million, an increase of $2.1 million, compared to $38.0 million for the nine months ended October 1, 2011. Net income was down approximately $0.9 million from the prior period. However, the prior period included a non cash gain on investment of HCT of approximately $1.2 million, which reduced prior period cash from operations. Changes in working capital relating to increases in accounts receivable and inventory were $2.5 million during 2012, compared to $3.8 million during 2011. Increases in accounts payable and accruals were $3.8 million during 2012, compared to $5.1 million during 2011. Cash on hand increased $5.7 million from $45.1 million at the end of 2011 to $50.7 million at September 29, 2012. Days sales outstanding (DSO) were 34 at September 29, 2012, and October 1, 2011. Inventory turns were 9.1 as of September 29, 2012, and 10.7 as of October 1, 2011.

Capital expenditures, consisting primarily of purchases of machinery and equipment, were $6.7 million for the nine months ended September 29, 2012, compared to $6.8 million for the nine months ended October 1, 2011. Capital expenditures for the year are projected to be approximately $13.0 million.

In January 2012, the Company applied for permitting to begin site preparation for a planned expansion on property the Company currently owns. The new facility, when completed, will have 60,000 square feet of manufacturing and 16,000 square feet of office space. The total investment is estimated to be approximately $16.0 million.

Included in capital expenditures for 2012 is approximately $6.0 million relating to the new facility. Also included in our annual estimate is $2.0 million for an expansion and update of our U.K. facility. The remaining expenditures consist of purchases of machinery and equipment.

The Company declared a quarterly cash dividend of $0.09 per share payable on October 15, 2012, to shareholders of record as of September 30, 2012. 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 does not engage in any off balance sheet financing arrangements. In particular, the Company does not have any material interest in variable interest entities, which include special purpose entities and structured finance entities.

The Company uses the equity method of accounting to account for its investment in WhiteOak. The Company does not have a majority ownership in or exercise control over the entity. The investment was not material to the financial statements of the Company at September 29, 2012.

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. 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 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, inventory, goodwill, accruals, and income taxes. The Company's critical accounting policies and estimates are included in its Annual Report on Form 10-K for the year ended December 31, 2011, and did not change during the first nine months of 2012.

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 costs, 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 Item 1. "Business," and Item 1A. "Risk Factors" in the Company's Form 10-K for the year ended December 31, 2011, and "Management's Discussion and Analysis of Financial Conditions and Results of Operations" in this Form 10-Q for the quarter ended September 29, 2012. 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's interest rate on its debt financing remains variable based upon the Company's leverage ratio. The Company had no variable-rate debt outstanding at September 29, 2012. A 1% change in interest rates up or down would have an immaterial affect on the Company's income statement on an annual basis at the current, variable-rate outstanding debt level.

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 September 29, 2012, 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. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, and is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. 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 at the reasonable assurance level as of September 29, 2012, in timely alerting them to material information required to be included in the Company's periodic SEC filings.

There were no changes in the Company's internal controls over financial reporting during the period ended September 29, 2012, 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 1A. Risk Factors.

For information regarding risk factors, please refer to Part I, Item 1A in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosure

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibits:

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Exhibit Number	Exhibit Description
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.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Sarasota, State of Florida on November 7, 2012.

SUN HYDRAULICS CORPORATION

By: /s/ Tricia L. Fulton
Tricia L. Fulton
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 September 29, 2012, 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 Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) 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

(d) 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: November 7, 2012

/s/ Allen J. Carlson

Allen J. Carlson
President, Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION

I, Tricia L. Fulton, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended September 29, 2012, 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 Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) 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

(d) 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: November 7, 2012

/s/ Tricia L. Fulton

Tricia L. Fulton
Chief Financial Officer

EXHIBIT 32.1

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

I, Allen J. 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 September 29, 2012 (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 J. Carlson

Chief Executive Officer

November 7, 2012

EXHIBIT 32.2

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

I, Tricia L. Fulton, 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 September 29, 2012 (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/ Tricia L. Fulton
Chief Financial Officer
November 7, 2012