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 October 1, 2016 **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 26,931,821 shares of common stock, par value $.001, outstanding as of October 28, 2016.

Sun Hydraulics Corporation
INDEX
For the quarter ended
October 1, 2016

		Page
PART I. FINANCIAL INFORMATION		
Item 1.	Financial Statements	
	Consolidated Balance Sheets as of October 1, 2016 (unaudited) and January 2, 2016	3
	Consolidated Statements of Operations for the Three Months Ended October 1, 2016 (unaudited) and September 26, 2015 (unaudited)	4
	Consolidated Statements of Operations for the Nine Months Ended October 1, 2016 (unaudited) and September 26, 2015 (unaudited)	5
	Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended October 1, 2016 (unaudited) and September 26, 2015 (unaudited)	6
	Consolidated Statement of Changes in Shareholders' Equity for the Nine Months Ended October 1, 2016 (unaudited)	7
	Consolidated Statements of Cash Flows for the Nine Months Ended October 1, 2016 (unaudited) and September 26, 2015 (unaudited)	8
	Notes to the Consolidated, Unaudited Financial Statements	9
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	19
	Forward Looking Information	24
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	25
Item 4.	Controls and Procedures	25
PART II. OTHER INFORMATION		
Item 1.	Legal Proceedings	26
Item 1A.	Risk Factors	26
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	26
Item 3.	Defaults Upon Senior Securities	26
Item 4.	Mine Safety Disclosure	26
Item 5.	Other Information	26
Item 6.	Exhibits	27

PART I: FINANCIAL INFORMATION

Item 1.

Sun Hydraulics Corporation
Consolidated Balance Sheets
(in thousands, except share data)

	October 1, 2016 (unaudited)	January 2, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 110,022	$ 81,932
Restricted cash	39	44
Accounts receivable, net of allowance for doubtful accounts of $163 and $184	17,701	13,531
Inventories	12,530	13,047
Income taxes receivable	509	123
Deferred income taxes	469	460
Short-term investments	33,858	44,174
Other current assets	3,397	3,707
Total current assets	178,525	157,018
Property, plant and equipment, net	71,235	74,121
Goodwill	4,912	4,988
Other assets	6,830	5,413
Total assets	**$ 261,502**	**$ 241,540**
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	$ 5,536	$ 4,422
Accrued expenses and other liabilities	5,203	4,849
Dividends payable	2,424	2,411
Total current liabilities	13,163	11,682
Deferred income taxes	8,919	7,411
Other noncurrent liabilities	-	260
Total liabilities	22,082	19,353
Commitments and contingencies	-	-
Shareholders' equity:		
Preferred stock, 2,000,000 shares authorized, par value $0.001, no shares outstanding	-	-
Common stock, 50,000,000 shares authorized, par value $0.001, 26,925,940 and 26,786,518 shares outstanding	27	27
Capital in excess of par value	88,664	82,265
Retained earnings	161,791	149,938
Accumulated other comprehensive income (loss)	(11,062)	(10,043)
Total shareholders' equity	239,420	222,187
Total liabilities and shareholders' equity	**$ 261,502**	**$ 241,540**

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	
	October 1, 2016 (unaudited)	September 26, 2015 (unaudited)
Net sales	**$ 45,232**	**$ 48,036**
Cost of sales	29,692	29,536
Gross profit	**15,540**	**18,500**
Selling, engineering and administrative expenses	8,297	7,463
Operating income	**7,243**	**11,037**
Interest (income) expense, net	(298)	(361)
Foreign currency transaction (gain) loss, net	(46)	(140)
Miscellaneous (income) expense, net	30	(1,005)
Income before income taxes	**7,557**	**12,543**
Income tax provision	2,568	4,133
Net income	**$ 4,989**	**$ 8,410**
Basic net income per common share	**$ 0.19**	**$ 0.32**
Weighted average basic shares outstanding	26,923	26,695
Diluted net income per common share	**$ 0.19**	**$ 0.32**
Weighted average diluted shares outstanding	26,923	26,695
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.

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

	Nine months ended	
	October 1, 2016	September 26, 2015
	(unaudited)	(unaudited)
Net sales	**$ 147,069**	**$ 156,438**
Cost of sales	93,035	95,140
Gross profit	**54,034**	**61,298**
Selling, engineering and administrative expenses	24,461	22,077
Operating income	**29,573**	**39,221**
Interest (income) expense, net	(1,056)	(1,021)
Foreign currency transaction (gain) loss, net	(311)	(839)
Miscellaneous (income) expense, net	594	(793)
Income before income taxes	**30,346**	**41,874**
Income tax provision	10,160	13,839
Net income	**$ 20,186**	**$ 28,035**
Basic net income per common share	**$ 0.75**	**$ 1.05**
Weighted average basic shares outstanding	26,879	26,662
Diluted net income per common share	**$ 0.75**	**$ 1.05**
Weighted average diluted shares outstanding	26,879	26,662
Dividends declared per share	**$ 0.310**	**$ 0.360**

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

Sun Hydraulics Corporation
Consolidated Statements of Comprehensive Income (Loss) (unaudited)
(in thousands)

	Three months ended		Nine months ended	
	October 1, 2016	September 26, 2015	October 1, 2016	September 26, 2015
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Net income	$ 4,989	$ 8,410	$ 20,186	$ 28,035
Other comprehensive income (loss)				
Foreign currency translation adjustments, net of tax	321	(2,007)	(1,871)	(4,366)
Unrealized gain (loss) on available-for-sale securities, net of tax	199	(521)	852	(669)
Total other comprehensive income (loss)	520	(2,528)	(1,019)	(5,035)
Comprehensive income	$ 5,509	$ 5,882	$ 19,167	$ 23,000

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 (unaudited)
(in thousands)

	Preferred shares	Preferred stock	Common shares	Common stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance, January 2, 2016	-	$ -	26,786	$ 27	$ 82,265	$ 149,938	$ (10,043)	$ 222,187
Shares issued, Restricted Stock			43					$ -
Shares issued, other compensation			19					$ -
Shares issued, ESPP			27		830			$ 830
Shares issued, shared distribution			51		1,679			$ 1,679
Stock-based compensation					3,890			$ 3,890
Dividends declared						(8,333)		$ (8,333)
Net income						20,186		$ 20,186
Other comprehensive income (loss)							(1,019)	$ (1,019)
Balance, October 1, 2016	-	$ -	26,926	$ 27	$ 88,664	$ 161,791	$ (11,062)	$ 239,420

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

Sun Hydraulics Corporation
Consolidated Statements of Cash Flows
(in thousands)

	Nine months ended	
	October 1, 2016 (unaudited)	September 26, 2015 (unaudited)
Cash flows from operating activities:		
Net income	$ 20,186	$ 28,035
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,550	7,054
(Gain)Loss on disposal of assets	316	(1,086)
Provision (benefit) for deferred income taxes	998	100
Allowance for doubtful accounts	(21)	(14)
Stock-based compensation expense	3,890	2,975
(Increase) decrease in:		
Accounts receivable	(4,149)	641
Inventories	517	2,341
Income taxes receivable	(386)	-
Other current assets	310	(48)
Other assets	(773)	435
Increase (decrease) in:		
Accounts payable	1,114	156
Accrued expenses and other liabilities	2,033	914
Income taxes payable	-	(443)
Other noncurrent liabilities	(260)	(20)
Net cash provided by operating activities	31,325	41,040
Cash flows from investing activities:		
Investment in licensed technology	(850)	(1,425)
Capital expenditures	(4,507)	(4,697)
Proceeds from dispositions of equipment	2	1,645
Purchases of short-term investments	(24,699)	(20,666)
Proceeds from sale of short-term investments	35,389	17,459
Net cash provided by (used in) investing activities	5,335	(7,684)
Cash flows from financing activities:		
Proceeds from stock issued	830	772
Dividends to shareholders	(8,321)	(9,596)
Change in restricted cash	5	21
Net cash used in financing activities	(7,486)	(8,803)
Effect of exchange rate changes on cash and cash equivalents	(1,084)	(4,781)
Net increase (decrease) in cash and cash equivalents	28,090	19,772
Cash and cash equivalents, beginning of period	**81,932**	**56,843**
Cash and cash equivalents, end of period	**$ 110,022**	**$ 76,615**
Supplemental disclosure of cash flow information:		
Cash paid:		
Income taxes	$ 9,047	14,575
Supplemental disclosure of noncash transactions:		
Common stock issued for shared distribution through accrued expenses and other liabilities	$ 1,679	3,535

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

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, South 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 Incheon, South Korea, operates a manufacturing and distribution facility. In 2012, Sun Korea acquired Seungwon Solutions Corporation ("Seungwon"), also located in Incheon, South Korea, a component supplier to Sun Korea and third parties. Sun Hydraulics (France) ("Sun France"), a liaison office located in Bordeaux, France, is used to service the French 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. In 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. In 2013, Sun Hydraulics purchased the remaining 60% of WhiteOak Inc., which was merged into HCT. WhiteOak, designs and produces complementary electronic control products.

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 January 2, 2016, filed by Sun Hydraulics Corporation (together with its subsidiaries, the "Company") with the Securities and Exchange Commission on March 1, 2016. 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 nine month period ended October 1, 2016, are not necessarily indicative of the results that may be expected for the period ending December 31, 2016.

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	
	October 1, 2016	September 26, 2015	October 1, 2016	September 26, 2015
Net income	**$ 4,989**	**$ 8,410**	**$ 20,186**	**$ 28,035**
Weighted average basic shares outstanding	26,923	26,695	26,879	26,662
Basic net income per common share	**$ 0.19**	**$ 0.32**	**$ 0.75**	**$ 1.05**
Effect of dilutive stock options	-	-	-	-
Weighted average diluted shares outstanding	26,923	26,695	26,879	26,662
Diluted net income per common share	**$ 0.19**	**$ 0.32**	**$ 0.75**	**$ 1.05**

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 2011 Equity Incentive Plan ("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 October 1, 2016, 522,212 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 October 1, 2016 and September 26, 2015, totaled $3,051 and $2,159, respectively.

The following table summarizes restricted stock activity from January 2, 2016, through October 1, 2016:

	Number of shares (in thousands)	**Weighted average grant-date fair value**
Nonvested balance at January 2, 2016	161	33.54
Granted	45	33.22
Vested	(16)	36.41
Forfeitures	(2)	34.22
Nonvested balance at October 1, 2016	188	33.21

The Company had $2,655 of total unrecognized compensation cost related to restricted stock awards granted under the 2011 Plan as of October 1, 2016. That cost is expected to be recognized over a weighted average period of 0.99 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 26,575 shares at a weighted average price of $25.99, and 23,607 shares at a weighted average price of $32.71, under the ESPP during the nine months ended October 1, 2016 and September 26, 2015, respectively. The Company recognized $221 and $159 of compensation expense during the nine months ended October 1, 2016 and September 26, 2015, respectively. At October 1, 2016, 592,765 shares remained available to be issued through the ESPP and the U.K. plan.

In March 2012, 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 initially adopted, 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 was paid 500 shares of Common Stock. The Chairman's fee was twice that of a regular director, and the fee for the chairs of each Board Committee was 125% that of a regular director. In February 2015, the Board adopted amendments to the 2012 Directors Plan which revised the compensation for Nonemployee Directors. Each Nonemployee Director now receives an annual retainer of 2,000 shares of Common Stock. The Chairman's retainer is twice that of a regular director, and the retainer for the chairs of each Board Committee is 150% that of a regular director. In addition, each Nonemployee Director receives 250 shares of Common Stock 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. In June 2015, the Company's shareholders approved the amendments to the 2012 Directors Plan.

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 35,000 shares. The 2012 Directors Plan authorizes the issuance of up to 270,000 shares of common stock. At October 1, 2016, 180,749 shares remained available for issuance under the 2012 Directors Plan. Directors were granted 18,625 and 17,500 shares for the nine months ended October 1, 2016 and September 26, 2015, respectively. The Company recognized director stock compensation expense of $588 and $617 for the nine months ended October 1, 2016 and September 26, 2015, respectively.

4. RESTRICTED CASH

A restricted cash reserve for customs and excise taxes in the U.K. operation was $39 at October 1, 2016. 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 is held with Lloyds TSB in the U.K.

5. INVENTORIES

	October 1, 2016	January 2, 2016
Raw materials	$ 5,129	$ 5,555
Work in process	4,429	4,478
Finished goods	3,461	3,464
Provision for slow moving inventory	(489)	(450)
Total	$ 12,530	$ 13,047

6. GOODWILL AND INTANGIBLE ASSETS

A summary of changes in goodwill at October 1, 2016 is as follows:

Balance at January 2, 2016	$ 4,988
Acquisitions	-
Currency translation	(76)
Balance at October 1, 2016	$ 4,912

Valuation models reflecting the expected future cash flow projections are used to value reporting units. A valuation of the reporting unit at January 2, 2016 indicated that there was no impairment of the carrying value of the goodwill at Sun Korea. A valuation of the reporting unit at October 1, 2016 indicated that there was no impairment of the carrying value of the goodwill at HCT.

The Company recognized $2,658 and $746 in identifiable intangible assets as a result of the acquisitions of HCT and WhiteOak, respectively. Intangible assets are held in other assets on the balance sheet. In 2014, the Company entered into a licensing agreement with Sturman Industries, Inc., recognizing intangible assets of $1,075 in 2014 and $1,425 in 2015, and $850 in the nine months ending October 1, 2016. The agreement is for licensed technology to be used with the Company's electrically actuated hydraulic cartridge valves. Royalties will be paid from the date of the first commercial sale and continue for fifteen years thereafter, or until the last related licensed patent expires, whichever is the later date. At October 1, 2016 and January 2, 2016, intangible assets consisted of the following:

	October 1, 2016			January 2, 2016		
	Gross carrying amount	Accumulated amortization	Net carrying amount	Gross carrying amount	Accumulated amortization	Net carrying amount
Definite-lived intangibles:						
Trade Name	$ 774	$ (397)	$ 377	$ 774	$ (340)	$ 434
Non-compete Agreement	11	(11)	-	11	(11)	-
Technology	935	(427)	508	935	(304)	631
Customer Relationships	1,751	(433)	1,318	1,751	(363)	1,388
Licensing Agreement	3,350	(315)	3,035	2,500	(140)	2,360
	$ 6,821	$ (1,583)	$ 5,238	$ 5,971	$ (1,158)	$ 4,813

Total estimated amortization expense for the years 2017 through 2021 is presented below. The remaining amortization for 2016 is approximately $114.

Year:	
2017	486
2018	486
2019	486
2020	486
2021	486
Total	$ 2,430

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 October 1, 2016.

7. LONG-TERM DEBT

On July 29, 2016 the Company entered into a new credit agreement (the “2016 Credit Agreement”), with PNC Bank, National Association (the “Bank”), as administrative agent, and the lenders party thereto.

The 2016 Credit Agreement provides the Company with a revolving line of credit (“the Facility”) of up to $100 million that is available through July 29, 2021. The 2016 Credit Agreement includes an accordion feature to increase the revolving line of credit by up to an additional $75 million. Interest is payable quarterly for loans under the Base Rate Option (as defined), and interest is payable on the last day of the applicable Interest Period (as defined) (and, if such Interest Period is longer than three (3) Months, interest is also payable on the 90th day of such Interest Period) for loans under the Euro Rate Option (as defined) . The loans under the facility will bear interest at the Euro Rate (as defined) or the Base Rate (as defined), at the Company’s option, plus the Applicable Margin (as defined) based on the Borrower’s Leverage Ratio (as defined). The Applicable Margin ranges from 1.25% to 2.00% for the Euro Rate and ranges from 0.25% to 1.00% for the Base Rate. Subject to customary breakage fees for loans under the Euro Rate Option that are prepaid on a day other than the last day of the applicable Interest Period, prepayment may be made without penalty or premium at any time upon the required notice to the Bank.

The 2016 Credit Agreement requires the Company (together with its subsidiaries) to comply with certain financial tests, including a minimum Interest Coverage Ratio (as defined) of 3.0 to 1.0 and a maximum Leverage Ratio (as defined) of 3.5 to 1.0. As of the date of this filing, the Company was in compliance with all debt covenants related to the Facility.

The 2016 Credit Agreement also requires the Company to comply with a number of restrictive covenants. These covenants limit, in certain circumstances, the Company’s ability to take a variety of actions, including but not limited to: incur indebtedness; create or maintain liens on its property or assets; make investments, loans and advances; repurchase shares of its Common Stock; engage in acquisitions, mergers, joint ventures, consolidations and asset sales; and pay dividends and distributions.

The 2016 Credit Agreement contains customary default provisions and has various non-financial covenants, both requiring the Company to refrain from taking certain future actions (as described above) and requiring the Company to take certain affirmative actions, such as maintaining its corporate existence, paying liabilities timely, maintaining insurance, and providing its bank lending group with financial information on a timely basis. Maturity of the Credit Facility may be accelerated by the Bank upon an Event of Default (as defined).

The Company and certain of its subsidiaries agreed to take certain actions to secure borrowings under the 2016 Credit Agreement. As a result, (i) the Company entered into a Pledge Agreement with the Bank, for the benefit of the lenders, granting a security interest in certain equity ownership in certain of its subsidiaries to secure amounts borrowed under the 2016 Credit Agreement and (ii) the Company’s domestic subsidiary entered into a Guaranty Agreement guarantying payment and performance of the Company’s obligations under the 2016 Credit Agreement.

The 2016 Credit Agreement incorporates sub-facilities for swing loans up to $15 million and issuance of letters of credit up to $5 million. Swing loans and letters of credit issued under the 2016 Credit Agreement decrease availability under the $100 million revolving line of credit. The Company did not have any amounts drawn on the 2016 Credit Agreement for the period ended October 1, 2016. The 2016 Credit Agreement replaced a credit and security agreement with Fifth Third Bank that had been in place since August 1, 2011 (the “Fifth Third Agreement”). The Fifth Third Agreement initially provided for three separate credit facilities totaling $50,000. These included a $15,000 unsecured revolving line of credit, an accordion feature to increase the revolving line of credit to a $35,000 secured revolving line of credit, and a $15,000 construction and term loan (originally obtained to provide financing for the construction of the Company’s third factory in Sarasota). The construction and term loan was never activated, nor did the Company make any borrowings under the other facilities provided by the Fifth Third Agreement. Accordingly, there were no amounts drawn under the Fifth Third Agreement for the periods ended October 1, 2016, and September 26, 2015. At October 1, 2016, the facilities with Fifth Third Bank are no longer available.

8. INCOME TAXES

At October 1, 2016, the Company had an unrecognized tax benefit of $328 including accrued interest. 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 October 1, 2016, 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 2007 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 2007 through 2012. 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 2007 through 2012 with the IRS and that there could be significant increases or decreases to unrecognized tax benefits.

9. SEGMENT REPORTING

The individual subsidiaries comprising the Company operate predominantly in a single industry as manufacturers and distributors of hydraulic components. Given the similar nature of products offered for sale, the type of customers, the methods of distribution and how the Company is managed, the Company determined that it has only one operating and reporting segment for both internal and external reporting purposes.

Geographic Region Information:

Net sales are measured based on the geographic destination of sales. Total and long-lived assets are shown based on the physical location of the assets. Long-lived assets primarily include net property, plant and equipment:

	Three months ended	
	October 1, 2016	**September 26, 2015**
Net sales		
Americas	21,425	23,678
Europe/Africa/ME	13,960	15,578
Asia/Pacific	9,847	8,780
Total	45,232	48,036

	YTD 2016	**YTD 2015**
Net sales		
Americas	69,541	75,507
Europe/Africa/ME	45,440	48,493
Asia/Pacific	32,088	32,438
Total	147,069	156,438

	October 1, 2016	**January 2, 2016**
Total assets		
Americas	188,193	168,662
Europe/Africa/ME	56,458	56,720
Asia/Pacific	16,851	16,158
Total	261,502	241,540
Long-lived assets		
Americas	71,676	72,529
Europe/Africa/ME	6,671	7,923
Asia/Pacific	4,630	4,070
Total	82,977	84,522

10. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company applies fair value accounting guidelines for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Under these guidelines, fair value is defined as the price that would be received for the sale of an asset or paid to transfer a liability (i.e. an exit price) in an orderly transaction between market participants at the measurement date. The guidance establishes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 - Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in inactive markets.

Level 3 - Unobservable inputs that are supported by little, infrequent, or no market activity and reflect the Company's own assumptions about inputs used in pricing the asset or liability.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company's valuation techniques used to measure the fair value of marketable equity securities and mutual funds were derived from quoted prices in active markets for identical assets or liabilities. The valuation techniques used to measure the fair value of all other financial instruments were valued based on quoted market prices or model driven valuations using significant inputs derived from or corroborated by observable market data.

The Company's short-term investments have been classified and accounted for as available-for-sale. Management determines the appropriate classification of its investments at the time of purchase and reevaluates the designation at each balance sheet date. The Company may or may not hold securities with stated maturities greater than 12 months until maturity. As management views these securities as available to support current operations, the Company classifies securities with maturities beyond 12 months as current assets under the caption short-term investments in the accompanying Consolidated Balance Sheets. These investments are carried at fair value, with the unrealized gains and losses reported as a component of shareholder's equity. Realized gains and losses on sales of investments are generally determined using the specific identification method, and are included in miscellaneous (income) expense in the Consolidated Statements of Operations.

The following tables provide information regarding the Company's assets and liabilities measured at fair value on a recurring basis at October 1, 2016 and January 2, 2016.

	October 1, 2016			
	Adjusted Cost	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
Assets				
Level 1:				
Equity securities	-	-	-	-
Mutual funds	1,483	-	(185)	1,298
Subtotal	1,483	-	(185)	1,298
Level 2:				
Corporate fixed income	26,613	75	(478)	26,210
Municipal bonds	6,412	-	(62)	6,350
Certificates of deposit and time deposits	-	-	-	-
Asset backed securities	-	-	-	-
Subtotal	33,025	75	(540)	32,560
Total	34,508	75	(725)	33,858
Liabilities				
Level 2:				
Phantom stock units	$ 26	-	-	26
Total	$ 26	-	-	26

	January 2, 2016			
	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value
Assets				
Level 1:				
Equity securities	1,318	28	(36)	1,310
Mutual funds	2,611	1	(238)	2,374
Subtotal	3,929	29	(274)	3,684
Level 2:				
Corporate fixed income	35,936	8	(1,682)	34,262
Municipal bonds	2,897	-	(94)	2,803
Certificates of deposit and time deposits	2,947	-	-	2,947
Asset backed securities	498	-	(20)	478
Subtotal	42,278	8	(1,796)	40,490
Total	46,207	37	(2,070)	44,174
Liabilities				
Level 2:				
Phantom stock units	17	-	-	17
Total	17	-	-	17

The Company recognized a net realized loss on investments during the nine months ended October 1, 2016 of $296 and a net realized loss of $241 during the nine months ended September 26, 2015. As of October 1, 2016, gross unrealized losses related to individual securities that had been in a continuous loss position for 12 months or longer were not significant. The Company considers these unrealized losses in market value of its investments to be temporary in nature. When evaluating an investment for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, and the Company's intent to sell, or whether it is more likely than not it will be required to sell, the investment before recovery of the investment's cost basis. During the nine months ended October 1, 2016, the Company recognized an impairment charge of $276, which is included in the net realized loss for the period. There were no other-than-temporary impairments during the nine month periods ended September 26, 2015.

Maturities of investments at October 1, 2016 are as follows:

	Adjusted Cost	Fair Value
Due in less than one year	$ 18,199	$ 18,122
Due after one year but within five years	11,691	11,410
Due after five years but within ten years	1,801	1,758
Due after ten years	1,334	1,270
Total	$ 33,025	$ 32,560

The Company reports phantom stock units as a liability. The Company recognized expense relating to this liability of $9 and $10, for the nine month periods ended October 1, 2016 and September 26, 2015, respectively. Phantom stock units vest over a period of three years.

The Company did not have any fair value adjustments for assets and liabilities measured at fair value on a nonrecurring basis during the period ended October 1, 2016.

11. ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in Accumulated Other Comprehensive Income by Component
Nine Months Ended October 1, 2016

	Unrealized Gains and Losses on Available-for-Sale Securities	Foreign Currency Items	Total
Balance at January 2, 2016	$ (1,262)	$ (8,781)	$ (10,043)
Other comprehensive income (loss) before reclassifications	666	(1,871)	(1,205)
Amounts reclassified from accumulated other comprehensive income	186	-	186
Net current period other comprehensive income (loss)	852	(1,871)	(1,019)
Balance at October 1, 2016	$ (410)	$ (10,652)	$ (11,062)

Reclassifications out of Accumulated Other Comprehensive Income
Nine Months Ended October 1, 2016

Details about Accumulated Other Comprehensive Income Components	Nine Months Ended October 1, 2016	Affected Line Item in the Consolidated Statements of Operations
Unrealized gains and losses on available-for-sale securities		
Realized gain/(loss) on sale of securities	$ (20)	Miscellaneous (income) expense, net
Other than temporary impairment	(276)	Miscellaneous (income) expense, net
	(296)	Total before tax
	110	Tax benefit
	$ (186)	Net of tax
Total reclassifications for the period	$ (186)	

12. NEW ACCOUNTING PRONOUNCEMENTS

In June 2016, the FASB issued guidance on a new credit loss standard that replaces the incurred loss impairment methodology in current GAAP. The new impairment model requires immediate recognition of estimated credit losses expected to occur for most financial assets and certain other instruments. For available-for-sale debt securities with unrealized losses, the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. It is effective for annual reporting periods beginning after December 15, 2019 and interim periods within those annual periods. Early adoption for fiscal year beginning after December 15, 2018 is permitted. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first effective reporting period. The Company does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

In March 2016, the FASB issued guidance on Compensation-Stock Compensation, Improvements to Employee Share-Based Payment Accounting, which is intended to simplify several aspects of accounting for share-based payment awards. The effective date will be the first quarter of fiscal year 2017, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

In March 2016, the FASB issued guidance on Investments-Equity Method and Joint Ventures which eliminates the retroactive adjustments to an investment qualifying for the equity method of accounting as a result of an increase in the level of ownership interest or degree of influence by the investor. The effective date will be the first quarter of fiscal year 2017. The Company does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

In March 2016, the FASB issued guidance on Derivatives and Hedging which simplifies the embedded derivative analysis for debt instruments containing contingent call or put options by clarifying that an exercise contingency does not need to be evaluated to determine whether it relates to interest rates and credit risk in an embedded derivative analysis. The effective date will be the first quarter of fiscal year 2017, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued guidance on Accounting for Leases, which requires an entity to recognize both assets and liabilities arising from financing and operating leases, along with additional qualitative and quantitative disclosures. The guidance is effective for reporting periods beginning after December 15, 2018 with early adoption permitted. The Company is currently evaluating the effects, if any, adoption of this guidance will have on the Company’s consolidated financial statements.

In January 2016, the FASB issued guidance on changes to the accounting for financial instruments that primarily affect equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. This standard is effective in 2018 with certain provisions allowing for early adoption. The Company is currently evaluating the effects, if any, adoption of this guidance will have on the Company’s consolidated financial statements.

In November 2015, the FASB issued guidance that requires all deferred tax assets and liabilities, along with any related valuation allowance, to be classified as noncurrent on the Consolidated Statement of Financial Position. Previous guidance requires the deferred taxes for each jurisdiction to be presented as a net current asset or liability and net noncurrent asset or liability. As a result of the new guidance, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The new guidance does not change the existing requirement that only permits offsetting deferred tax assets and liabilities within a single jurisdiction. The new guidance is effective January 1, 2017, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on the Company’s consolidated financial statements.

In July 2015, the FASB issued guidance on Simplifying the Measurement of Inventory. The guidance requires inventory be measured at the lower of cost and net realizable value. Additionally, the guidance defines net realizable value as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The guidance is effective for reporting periods beginning after December 15, 2016 and interim periods within those fiscal years with early adoption permitted. The guidance should be applied prospectively. The Company does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

In August 2014, the FASB issued guidance on Disclosure of Uncertainties About an Entity’s Ability to Continue as a Going Concern. The guidance requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity’s ability to continue as a going concern. The guidance applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued guidance on Revenue from Contracts with Customers, to clarify the principles used to recognize revenue for all entities. The core principle of the new guidance is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. The standard provides a five-step analysis of transactions to determine when and how revenue is recognized. Additionally, the guidance requires disaggregated disclosures related to the nature, amount, timing, and uncertainty of revenue that is recognized. The guidance was originally to be effective for annual and interim periods beginning after December 15, 2016. The FASB has subsequently delayed this standard by one year. Early adoption is permitted as of the original effective date. The Company is currently evaluating the effects, if any, adoption of this guidance will have on the Company’s consolidated financial statements.

13. 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.

14. SUBSEQUENT EVENT

On November 7, 2016, the Company entered into a Unit Purchase Agreement with Murphy Group, Inc., an Oklahoma corporation, and EControls Group, Inc., a Texas corporation, which together own a majority of the outstanding membership units of Enovation Controls, LLC, an Oklahoma-based company, to acquire all of the outstanding membership units of Enovation Controls, LLC and retain its Power Controls (PC) and Vehicle Technologies (VT) lines of business only. The acquisition has a potential value of $250 million, including initial consideration of $200 million and additional earn-out potential of $50 million. We expect to utilize a combination of existing cash and cash equivalents and proceeds from our existing revolving line of credit to effect this transaction. Enovation’s complementary products expand Sun’s complete system solution portfolio while developing product and end market diversification. The acquisition is subject to customary closing conditions and is expected to close in the fourth quarter of 2016. It is not currently practicable, based on the pending status of the acquisition, for us to disclose pro forma results of operations or financial position.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Sun 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 January 2, 2016, were approximately 58% 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.

In recent periods, the Company's products have been used by emerging markets that have characteristics of both the mobile and industrial markets and do not conveniently fit either classification exclusively. These markets include alternative energy equipment including wind, wave and solar equipment, animatronics and staging for theater and cinema. The Company sells to these markets the same products used in its traditional markets.

Management and Operations Philosophy

Since its inception, Sun has operated as an entrepreneurial enterprise, with an emphasis on individual employee empowerment and a disinclination to create bureaucracy, a formal management structure or administrative impediments to innovation, efficiency and customer service. Accordingly, the Company's organization, management structure, and reporting and decision-making systems are highly unified and unlayered.

In addition to representative and sales offices located throughout the world, Sun has three subsidiaries outside the United States (in the U.K., Germany and Korea) and one U.S. subsidiary. These entity distinctions arose out of historical considerations or as the result of acquisitions. Nevertheless, and increasingly as it has developed into a global enterprise, the Company is operated and managed on a consolidated basis. Much of the Company's primary financial and operations data is reported from Sun's various legal entities, which are separate taxpayers and, in many cases, subject to statutory audits in the countries in which they are organized. This information from Sun locations around the world is then compiled and aggregated, with appropriate consolidating entries, on a monthly basis. However, Sun does not manage or make decisions based on the individual legal entity information. Instead, this is done on the basis of the consolidated information.

Sun has always employed a leadership model in which all management personnel have line responsibilities and participate across functional lines and in multiple areas, including geographical areas. Through a common vision, shared values and networks of informal, overlapping relationships, the Company has emphasized a unified approach. The CEO oversees the Company with a constant focus on consolidated results.

With oversight from its Board of Directors and an emphasis on transparent communication across the entire Company, Sun's operating strategy and business is based upon the creation and manufacture of a comprehensive line of functional products which are sold, through distribution and directly, worldwide for use in a host of mobile and industrial applications. This unified focus places a premium on the delivery of Sun products for fluid power solutions anywhere in the world in the most efficient manner, with little regard for traditional geographic or entity differentiation. Instead, Sun's management looks at where products are sold - the Americas, Europe (which includes the Middle East and Africa), and Asia/Pacific. Decisions as to resource allocation, expansion of facilities and personnel, and capital investment are all made based on information on "sales to" customers, not information about "sales from" Sun subsidiary entities. This reflects the fact that sales are routinely specified, originated or sold beyond and regardless of entity or geographic boundaries. In particular, many of the sales in Europe and Asia come directly from the U.S. and never pass through one of Sun's subsidiary entities in those regions.

Management's focus is on overall Company performance and the evaluation of opportunities for additional "sales to" customers. Sun's CEO truly acts as the chief executive for the entire business; he and the other management leaders oversee operations worldwide, without an intermediate reporting bureaucracy in each location in which Sun has a legal entity. Using "shared offices," leadership responsibilities are disbursed throughout the Company, with minimal formal reporting relationships and maximum collaboration among employees worldwide. By focusing on total net orders and total net sales, not individual legal entity performance, Sun is able to better serve its customers. This philosophy permeates not only the management approach to decision-making, but also the Company's compensation system, which is based on company-wide performance, and not individual or entity-level management-by-objective criteria.

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% in 2015 after increasing 6% in 2014. The index of shipments of hydraulic products decreased 10% for the nine month period ending September 30, 2016.

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 increased to 51.5 in September 2016 compared to 50.2 in September 2015. The U.S. PMI index registered 51.9 for October 2016.

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

	October 1, 2016	September 26, 2015	Increase/Decrease
Three Months Ended			
Net sales	$ 45.2	$ 48.0	(6)%
Net income	$ 5.0	$ 8.4	(41)%
Net income per share:			
Basic	$ 0.19	$ 0.32	(41)%
Diluted	$ 0.19	$ 0.32	(41)%
Nine Months Ended			
Net sales	$ 147.1	$ 156.4	(6)%
Net income	$ 20.2	$ 28.0	(27)%
Net income per share:			
Basic	$ 0.75	$ 1.05	(29)%
Diluted	$ 0.75	$ 1.05	(29)%

Third quarter sales were slightly below management's expectations. Overall, global demand declined 6% due to persistent headwinds. Sluggish end markets continued to strain demand in the Americas and Europe as both experienced a 10% decline, while Asia Pacific remained up more than 12% for the quarter. Sales and marketing investments in this region are having significant influence on Sun's ability to win new customers and expand market share. A strong U.S dollar adversely affected EPS by $0.02, however it was still within management's expected range.

Coming out of the third quarter, October order rates are showing signs of improvement. Leading indicators are supportive of positive momentum in 2017. Sun remains focused on exceeding customer expectations, growing global presence, and delivering strong financial results. Operationally, lean initiatives are taking shape and will drive profitability once fully implemented. Sales and marketing efforts are ramping up regionally, providing Sun with better opportunities to address customers' needs and drive growth.

Outlook

Please note: Fourth quarter estimates exclude any impact related to financial consolidation for the acquisition of Enovation Controls. Fourth quarter 2016 revenues are expected to be approximately $46 million, up 3% from the fourth quarter of 2015. Earnings per share are estimated to be $0.13 to $0.15, compared to $0.19 in the same period a year ago. Several non-recurring items, noted below, are expected to decrease EPS for Q4 2016.

- M&A activity expenses, including professional fees associated with the acquisition of Enovation Controls of approximately $0.05.
- Global sales and marketing expenses of approximately $0.02.
- CEO transition expenses of approximately $0.01 (transition costs will continue to reduce earnings through the first quarter of 2017).

- Currency is not expected to have a substantial impact on earnings per share in fourth quarter estimates.

COMPARISON OF THE THREE MONTHS ENDED OCTOBER 1, 2016 AND SEPTEMBER 26, 2015

Net Sales

Net sales were $45.2 million, a decrease of $2.8 million, or 5.8%, compared to $48.0 million in the third quarter of 2015. The decrease in net sales was driven by weaker demand in all markets. Changes in exchange rates had a negative impact on sales of approximately $0.6 million. New product sales (defined as products introduced within the last five years) continue to make up 10 - 12% of total sales.

Asia/Pacific sales increased 12.2% or $1.1 million, to $9.8 million in the third quarter of 2016, primarily related to increased demand in China. Exchange rates had a $0.1 million positive impact on Asia/Pacific sales in the third quarter of 2016. EAME sales decreased 10.4% or $1.6 million, to $14.0 million in the third quarter of 2016, primarily related to decreased demand in the United Kingdom, Germany, Finland and Norway. Exchange rates had a negative impact on sales to EAME of approximately $0.7 million in the third quarter of 2016. Sales to the Americas decreased 9.5% or $2.3 million, to $21.4 million in the third quarter of 2016, primarily related to decreased demand in the U.S.

Gross Profit

Gross profit decreased $3.0 million or 16.0%, to $15.5 million in the third quarter of 2016, compared to $18.5 million in the third quarter of last year. Gross profit as a percentage of net sales decreased to 34.4% in the third quarter of 2016, compared to 38.5% in the third quarter of last year. Lower sales volume reduced gross profit by approximately $1.1 million. The remainder of the decrease is made up of increased overhead costs related to compensation.

Selling, Engineering and Administrative Expenses

Selling, engineering and administrative expenses increased $0.8 million or 11.2%, to $8.3 million in the third quarter of 2016, compared to $7.5 million in the third quarter of last year. The increase relates primarily to the CEO transition and increased compensation costs.

Operating Income

Operating income decreased $3.8 million or 34.4%, to $7.2 million in the third quarter of 2016, compared to $11.0 million in the third quarter last year, with operating margins of 16.0% and 23.0% for the third quarters of 2016 and 2015, respectively.

The Company derives its operating income based on the consolidated results of its legal entities. The Company has made the decision to consolidate engineering and manufacturing for the most part in the U.S. The Company's foreign subsidiaries primarily act as part of our sales and distribution channel. This structure results in different operating margins among the legal entities due to the mix of products, channels to market, and industries present in different geographic regions.

Products manufactured in the U.S. are sold worldwide. Pricing, operations and cost structure are the primary reasons that operating income in the U.S. is higher than foreign subsidiary operating income, which we expect will continue. Our German and U.K. entities act as value add distributors. These entities sell to both end use customers in their respective regions, as well as to third party distributors in certain parts of Europe. U.K. margins have historically been lower than in Germany. This is due to the fact that, in the U.K., we manufacture iron manifolds for the European market. This results in higher overhead costs primarily related to machinery and equipment, and the employment of nearly twice as many people as in Germany. Margins are lowest in our Korean entity. Korea, more than any other subsidiary, sells direct to large OEM customers where pricing pressure is most pronounced.

The U.S. legal entity contributed $6.4 million to our consolidated operating income in the third quarter 2016, compared to $12.1 million in the third quarter of 2015, a decrease of $5.7 million. The decrease is primarily related to volume and increased compensation costs. The U.S. legal entity ships products directly to customers around the world. Third party export sales from the U.S. were $14.5 million in the third quarter of 2016 compared to $13.5 million in the third quarter of 2015. As demand strengthens internationally, the U.S. legal entity will benefit from these direct export sales.

Our Korean subsidiary had a minimum impact on our consolidated operating income in the third quarter of 2016 compared to an operating loss of $0.7 million in the third quarter of 2015.

Our German subsidiary contributed $0.7 million to our consolidated operating income in the third quarter of 2016 compared to an operating loss of $0.9 million during the third quarter of 2015.

Our U.K. subsidiary contributed $0.2 million to our consolidated operating income in the third quarter of 2016 compared to $0.6 million in the third quarter of 2015.

Interest Income, Net

Net interest income was $0.3 million for the quarter ended October 1, 2016 and $0.4 million for the quarter ended September 26, 2015. The Company currently has no outstanding debt. Total average cash and investments for the quarter ended October 1, 2016, was $140.9 million compared to $119.1 million for the quarter ended September 26, 2015.

Miscellaneous (Income) Expense, Net

Net miscellaneous expense was minimal for the quarter ended October 1, 2016, compared to net miscellaneous income of $1.0 million for the quarter ended September 26, 2015. The increase in 2015 was related to the gain on disposal of the building at our Korean operation.

Income Taxes

The provision for income taxes for the quarter ended October 1, 2016, was 34.0% of pretax income compared to 33.0% for the quarter ended September 26, 2015. This effective rate 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 OCTOBER 1, 2016 AND SEPTEMBER 26, 2015

Net Sales

Net sales were $147.1 million, a decrease of $9.4 million, or 6.0%, compared to $156.4 million in 2015. The decrease in net sales was driven by weaker demand in all markets. Changes in exchange rates had a negative impact on sales of approximately $1.7 million. New product sales (defined as products introduced within the last five years) continue to make up 10 - 12% of total sales.

Asia/Pacific sales decreased 1.1% or $0.4 million, to $32.1 million in 2016, primarily related to decreased demand from Korea. Exchange rates had a $0.5 million negative impact on Asia/Pacific sales in 2016. EAME sales decreased 6.3% or $3.1 million, to $45.4 million in 2016, primarily related to decreased demand in Germany, the United Kingdom, and Norway. Exchange rates had a negative impact on sales to EAME of approximately $1.2 million in 2016. Sales to the Americas decreased 7.9% or $6.0 million, to $70.1 million in 2016, primarily related to decreased demand in the U.S.

Gross Profit

Gross profit decreased $7.3 million or 11.9%, to $54.0 million in 2016, compared to $61.3 million in 2015. Gross profit as a percentage of net sales decreased to 36.7% in 2016, compared to 39.2% last year. Lower sales volume reduced gross profit by approximately $3.7 million. The remainder of the decrease resulted from higher costs as a percentage of sales related to overhead costs of $3.1 million.

Selling, Engineering and Administrative Expenses

Selling, engineering and administrative expenses increased $2.4 million or 10.8%, to $24.5 million in 2016, compared to $22.1 million last year. The increase relates primarily to the CEO transition.

Operating Income

Operating income decreased $9.6 million or 24.6%, to $29.6 million in 2016, compared to $39.2 million last year, with operating margins of 20.1% and 25.1% for 2016 and 2015, respectively.

The Company derives its operating income based on the consolidated results of its legal entities. The Company has made the decision to consolidate engineering and manufacturing for the most part in the U.S. The Company's foreign subsidiaries primarily act as part of our sales and distribution channel. This structure results in different operating margins among the legal entities due to the mix of products, channels to market, and industries present in different geographic regions.

Products manufactured in the U.S. are sold worldwide. Pricing, operations and cost structure are the primary reasons that operating income in the U.S. is higher than foreign subsidiary operating income, which we expect will continue. Our German and U.K. entities act as value add distributors. These entities sell to both end use customers in their respective regions, as well as to third party distributors in certain parts of Europe. U.K. margins have historically been lower than in Germany. This is due to the fact that, in the U.K., we manufacture iron manifolds for the European market. This results in higher overhead costs primarily related to machinery and equipment, and the employment of nearly twice as many people as in Germany. Margins are lowest in our Korean entity. Korea, more than any other subsidiary, sells direct to large OEM customers where pricing pressure is most pronounced.

The U.S. legal entity contributed $26.1 million to our consolidated operating income in 2016, compared to $36.6 million in 2015, a decrease of $10.5 million. The decrease is primarily related to volume. The U.S. legal entity ships products directly to customers around the world. Third party export sales from the U.S. were $47.3 million in 2016 compared to $44.7 million in 2015. As demand strengthens internationally, the U.S. legal entity will benefit from these direct export sales.

Our Korean subsidiary had minimal impact to our consolidated operating income in 2016 compared to an operating loss of $0.6 million in 2015.

Our German subsidiary contributed $2.2 million to our consolidated operating income in 2016 compared to operating income of $1.2 million in 2015.

Our U.K. subsidiary contributed $1.2 million to our consolidated operating income in 2016 compared to $2.1 million in 2015.

Interest Income, Net

Net interest income was $1.1 million in 2016 and $1.0 million in 2015. The Company currently has no outstanding debt. Total average cash and investments for the nine months ended October 1, 2016, was $135.0 million compared to $111.5 million for the nine months ended September 26, 2015.

Miscellaneous (Income) Expense, Net

Net miscellaneous expense was $0.6 million in 2016, compared to net miscellaneous income of $0.8 million in 2015.

Income Taxes

The provision for income taxes for the nine months ended October 1, 2016, was 33.5% of pretax income compared to 33.0% for the nine months ended September 26, 2015. This effective rate relates to the relative levels 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 nine months ended October 1, 2016, was $31.3 million, a decrease of $9.7 million, compared to $41.0 million for the nine months ended September 26, 2015. Net income was down approximately $7.8 million from the prior year period. Changes in working capital related to increases in accounts receivable of $4.1 million during 2016, compared to decreases of $0.6 million during 2015. Decreases in inventory were $0.6 million during 2016, compared to a decrease of $2.3 million during 2015. Increases in accounts payable and accruals were $3.1 million during 2016, compared to $1.1 million during 2015. Cash on hand increased $28.1 million from $81.9 million at the end of 2015 to $110.0 million at October 1, 2016. Days sales outstanding (DSO) were 36 at October 1, 2016, and 32 at September 26, 2015. Inventory turns were 9.5 as of October 1, 2016, and 10.0 as of September 26, 2015.

Capital expenditures were $4.5 million for the nine months ended October 1, 2016, primarily made up of purchases of machinery and equipment. Capital expenditures for 2016 are estimated to be $6.0 million, primarily related to purchases of machinery and equipment.

The Company declared a quarterly cash dividend of $0.09 per share payable on October 15, 2016, to shareholders of record as of September 30, 2016. 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 interest in variable interest entities, which include special purpose entities and structured finance entities.

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 January 2, 2016, and did not change during the first nine months of 2016.

FORWARD-LOOKING INFORMATION

Certain oral statements made by management from time to time and certain statements connection here in that are not historical facts are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934. Forward-looking statements involve risks and uncertainties, and actual results may differ materially from those expressed or implied by such statements. They include 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 and make acquisitions; (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) fluctuations in global business conditions, including the impact of economic recessions in the U.S. and other parts of the world, (iii) conditions in the capital markets, including the interest rate environment and the availability of capital; (iv) 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; (v) risks related to the integration of the businesses of the Company and Enovation Controls; (vi) 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; (vii) new product introductions, product sales mix and the geographic mix of sales nationally and internationally; and (viii) 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 January 2, 2016, and "Management's Discussion and Analysis of Financial Conditions and Results of Operations" in this Form 10-Q for the quarter ended October 1, 2016. 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 October 1, 2016. Therefore, a 1% change in interest rates up or down would not have a material effect on the Company's income statement on an annual basis.

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 October 1, 2016, 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 Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(f). The Company's 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 October 1, 2016, 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 October 1, 2016, 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 January 2, 2016.

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

Below is a summary of stock repurchases for the three months ended October 1, 2016.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
July 3 through July 30	—			
July 31 through August 27	—			
August 28 through October 1	225	$ 30.75		

(1)	In connection with an award of 750 shares to one of the Company's directors as Board fees under the 2012 Nonemployee Director Fees Plan, the Company withheld 225 shares to satisfy federal tax withholding obligations on the award.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosure

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibits:

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.
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

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 8, 2016.

SUN HYDRAULICS CORPORATION

By: /s/ Tricia L. Fulton
Tricia L. Fulton
Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit 31.1

CERTIFICATION

I, Wolfgang H. Dangel, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended October 1, 2016, 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 8, 2016

/s/ Wolfgang H. Dangel

Wolfgang H. Dangel
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 October 1, 2016, 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 8, 2016

/s/ Tricia L. Fulton

Tricia L. Fulton
Chief Financial Officer

Exhibit 32.1

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

I, Wolfgang H. Dangel, 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 October 1, 2016 (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/ Wolfgang H. Dangel
Chief Executive Officer
November 8, 2016

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 October 1, 2016 (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 8, 2016