SUN HYDRAULICS CORP
Form 10-K/A
March 19, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

Amendment No. 1

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 30, 2006	**Commission file number 0-21835**

SUN HYDRAULICS CORPORATION

(Exact Name of Registration as Specified in its Charter)

Florida	**59-2754337**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
1500 West University Parkway	
Sarasota, Florida	**34243**
(Address of Principal Executive Offices)	**(Zip Code)**

941/362-1200

(Registrant s Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act

Title of Each Class	Name of each exchange on which registered
Common Stock $.001 Par Value	**NASDAQ Stock Market, LLC**

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

The aggregate market value of the shares of voting common stock held by non-affiliates of the Registrant, computed by reference to the closing sales price of such shares on the Nasdaq Stock Market, LLC, as of the last business day of the Registrant s most recently completed second fiscal quarter was $150,821,136.

As of March 2, 2007, there were 10,926,753 shares of common stock outstanding.

Explanatory Note

This Amendment is being filed to include the correct figures in the table under Item 8, Note 16 - Earnings Per Share of the Notes to the Consolidated Financial Statements.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to financial statements:

Report of Independent Registered Certified Public Accounting Firm

To the Board of Directors and Stockholders

Sun Hydraulics Corporation:

We have audited the accompanying consolidated balance sheet of Sun Hydraulics Corporation (a Florida corporation) and subsidiaries as of December 30, 2006, and the related statements of operations, shareholders equity and comprehensive income, and cash flows for the year then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sun Hydraulics Corporation and subsidiaries as of December 30, 2006, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Sun Hydraulics Corporation s internal control over financial reporting as of December 30, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our reported dated March 6, 2006, expressed an unqualified opinion on management s assessment of internal control over financial reporting and an unqualified opinion on the effectiveness of internal control over financial reporting.

/s/ Kirkland, Russ, Murphy & Tapp, P.A.
Clearwater, Florida

March 6, 2007

Report of Independent Registered Public Accounting Firm

To the Board of Directors and

Shareholders of Sun Hydraulics Corporation:

We have audited the accompanying consolidated balance sheet of Sun Hydraulics Corporation (a Florida corporation) and subsidiaries as of December 31, 2005, and the related consolidated statements of operations, shareholders equity and comprehensive income, and cash flows for each of the two years in the period ended December 31, 2005. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sun Hydraulics Corporation and subsidiaries as of December 31, 2005, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP
Tampa, Florida

March 6, 2006

Sun Hydraulics Corporation

Consolidated Balance Sheets

(in thousands, except for share information)

	December 30, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 9,379	$ 5,417
Restricted cash	118	413
Accounts receivable, net of allowance for doubtful accounts of $140 and $110	13,917	10,975
Inventories	10,386	7,870
Income taxes receivable		236
Deferred income taxes	219	782
Other current assets	986	864
Total current assets	35,005	26,557
Property, plant and equipment, net	50,355	45,181
Other assets	1,825	1,823
Total assets	**$ 87,185**	**$ 73,561**
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable	$ 4,812	$ 4,822
Accrued expenses and other liabilities	4,059	3,857
Long-term debt due within one year	426	398
Dividends payable	1,085	1,089
Income taxes payable	608	
Total current liabilities	10,990	10,166
Long-term debt due after one year	646	1,986
Deferred income taxes	4,451	4,688
Other noncurrent liabilities	298	281
Total liabilities	16,385	17,121
Commitments and contingencies (Note 19)		
Shareholders equity:		
Preferred stock, 2,000,000 shares authorized, par value $0.001, no shares outstanding		
Common stock, 20,000,000 shares authorized, par value $0.001, 10,849,316 and 10,893,421 shares outstanding	11	11
Capital in excess of par value	30,962	32,466
Unearned compensation related to outstanding restricted stock		(741)
Retained earnings	35,284	23,406
Accumulated other comprehensive income	4,543	1,647
Treasury stock (0 and 17,500 shares, at cost)		(349)
Total shareholders equity	70,800	56,440
Total liabilities and shareholders equity	**$ 87,185**	**$ 73,561**

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

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Sun Hydraulics Corporation

Consolidated Statements of Operations

(in thousands, except per share data)

	For the year ended		
	December 30, 2006	December 31, 2005	December 25, 2004
Net sales	**$ 142,282**	**$ 116,757**	**$ 94,503**
Cost of sales	98,350	79,839	65,968
Gross profit	**43,932**	**36,918**	**28,535**
Selling, engineering and administrative expenses	18,881	17,738	16,241
Operating income	**25,051**	**19,180**	**12,294**
Interest expense	312	441	527
Foreign currency transaction (gain) loss	187	(362)	0
Miscellaneous (income) expense	(351)	(36)	35
Income before income taxes	**24,903**	**19,137**	**11,732**
Income tax provision	8,680	6,329	3,902
Net income	**$ 16,223**	**$ 12,808**	**$ 7,830**
Basic net income per common share	**$ 1.49**	**$ 1.18**	**$ 0.76**
Weighted average basic shares outstanding	**10,878**	**10,827**	**10,269**
Diluted net income per common share	**$ 1.48**	**$ 1.17**	**$ 0.76**
Weighted average diluted shares outstanding	**10,939**	**10,918**	**10,346**
Dividends declared per share	**$ 0.400**	**$ 0.300**	**$ 0.143**

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

Sun Hydraulics Corporation

Consolidated Statement of Shareholders Equity and Comprehensive Income

(in thousands)

	Preferred Shares	Preferred Stock	Common Shares	Common stock	Capital in excess of par value	Unearned Compensation related to restricted stock	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
Balance, December 27, 2003		$	10,137	$ 10	$ 26,478	$ (601)	$ 7,519	$ 1,657	$	$ 35,063
Shares issued, Restricted Stock			30		257	(7)				250
Shares issued, Stock Options			284		1,711					1,711
Shares issued, ESPP					(74)					(74)
Shares retired, Repurchase Agreement			(9)		(83)					(83)
Purchase of treasury stock									(524)	(524)
Reissuance of treasury stock									513	513
Stock option income tax benefit					290					290
Dividends issued							(1,482)			(1,482)
Comprehensive income:										
Net income							7,830			7,830
Foreign currency translation adjustments								1,909		1,909
Comprehensive income:										9,739
Balance, December 25, 2004		$	10,442	$ 10	$ 28,579	$ (608)	$ 13,867	$ 3,566	$ (11)	$ 45,403
Shares issued, Restricted Stock			26		475	(133)				342
Shares issued, Stock Options			371	1	2,510					2,511
Shares issued, ESPP			12		157					157
Shares issued, ESOP			110		1,058					1,058
Shares retired, Repurchase Agreement			(68)		(1,250)				11	(1,239)
Purchase of treasury stock									(349)	(349)
Tax benefit of stock-based compensation					937					937
Dividends issued							(3,269)			(3,269)
Comprehensive income:										
Net income							12,808			12,808
Foreign currency translation adjustments								(1,919)		(1,919)

Comprehensive income:								10,889
Balance, December 31, 2005	$ 10,893	$ 11	$ 32,466	$ (741)	$ 23,406	$ 1,647	$ (349)	$ 56,440
Adjustment of unearned compensation, restricted stock			(741)	741				
Forfeitures, restricted stock	(2)							
Shares issued, Restricted Stock	30							
Shares issued, Stock Options	31		162					162
Shares issued, ESPP	14		238					238
Shares issued, ESOP	58		1,183					1,183
Shares retired, Repurchase Agreement	(175)		(3,300)				923	(2,377)
Purchase of treasury stock							(574)	(574)
Stock-based compensation			573					573
Tax benefit of stock-based compensation			381					381
Dividends issued					(4,345)			(4,345)
Comprehensive income:								
Net income					16,223			16,223
Foreign currency translation adjustments						2,896		2,896
Comprehensive income:								19,119
Balance, December 30, 2006	$ 10,849	$ 11	$ 30,962	$	$ 35,284	$ 4,543	$	$ 70,800

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

Sun Hydraulics Corporation

Consolidated Statements of Cash Flows

(in thousands)

	For the year ended		
	December 30, 2006	**December 31, 2005**	**December 25, 2004**
Cash flows from operating activities:			
Net income	$ 16,223	$ 12,808	$ 7,830
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	5,849	5,604	5,465
Loss on disposal of assets	12	22	73
Stock-based compensation expense	573	365	289
Stock options income tax benefit	(381)		
Allowance for doubtful accounts	30	(60)	(17)
Provision for slow moving inventory	157	(96)	110
Provision for deferred income taxes	326	(688)	138
(Increase) decrease in:			
Accounts receivable	(2,972)	(2,304)	(2,379)
Inventories	(2,673)	(669)	(594)
Income tax receivable	236	(236)	
Other current assets	(122)	(88)	(252)
Other assets, net	(29)	39	149
Increase (decrease) in:			
Accounts payable	(10)	2,286	97
Accrued expenses and other liabilities	1,385	306	2,392
Income taxes payable	989	(261)	1,437
Other liabilities	17	(19)	(28)
Net cash from operating activities	19,610	17,009	14,710
Cash flows from investing activities:			
Investment in WhiteOak		(400)	
Capital expenditures	(9,525)	(8,813)	(4,987)
Proceeds from dispositions of equipment	28	5	61
Net cash used in investing activities	(9,497)	(9,208)	(4,926)
Cash flows from financing activities:			
Proceeds from debt	7,000	11,599	
Repayment of debt	(8,312)	(21,469)	(5,953)
Proceeds from exercise of stock options	162	2,487	1,672
Stock options income tax benefit	381		
Proceeds from stock issued	238	157	
Payments for purchase of treasury stock	(2,951)	(1,588)	(781)
Proceeds from reissuance of treasury stock			613
Dividends to shareholders	(4,349)	(2,701)	(1,230)
Net cash used in financing activities	(7,831)	(11,515)	(5,679)
Effect of exchange rate changes on cash and cash equivalents	1,385	(218)	438
Net (decrease) increase in restricted cash	(295)	(49)	37
Net (decrease) increase in cash and cash equivalents	3,962	(3,883)	4,506
Cash and cash equivalents, beginning of period	5,830	9,762	5,219

Cash and cash equivalents, end of period	$ 9,497	$ 5,830	$ 9,762
Supplemental disclosure of cash flow information:			
Cash paid:			
Interest	$ 312	$ 441	$ 527
Income taxes	$ 7,510	$ 8,451	$ 2,617
Supplemental disclosure of noncash transactions:			
Common stock issued to ESOP through accrued expenses and other liabilities	$ 1,183	$ 1,058	$

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

SUN HYDRAULICS CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

1. BUSINESS

Sun Hydraulics Corporation, and its wholly-owned subsidiaries and joint ventures, 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, and China. Sun Hydraulics Corporation (Sun Hydraulics), with its main offices located in Sarasota, Florida, designs, manufactures, and sells primarily through distributors. Sun Hydraulik Holdings Limited (Sun Holdings), a wholly-owned subsidiary of Sun Hydraulics, was formed to provide a holding company for the European market operations; its wholly-owned subsidiaries are Sun Hydraulics Limited (a British corporation, Sun Ltd.) and Sun Hydraulik GmbH (a German corporation, Sun GmbH). Sun Ltd. operates a manufacturing and distribution facility located in Coventry, England, and Sun GmbH operates a manufacturing and distribution facility located in Erkelenz, Germany. Sun Hydraulics Korea Corporation (Sun Korea), a wholly-owned subsidiary of Sun Hydraulics, located in Inchon, South Korea, operates a manufacturing and distribution facility. Sun Hydraulics, SARL (Sun France), a wholly-owned subsidiary of Sun Hydraulics, located in Bordeaux, France, operates a sales and engineering support facility. Sun Hydraulics Systems (Shanghai) Co., Ltd. (Sun China), a 50/50 joint venture between Sun Hydraulics and Links Lin, the owner of Sun Hydraulics Taiwanese distributor, is located in Shanghai, China, and operates a manufacturing and distribution facility. Sun Hydraulics acquired a 40% equity method investment in WhiteOak Controls, Inc. (WhiteOak), on June 28, 2005 (see Note 3). WhiteOak, located in Mediapolis, Iowa, designs and produces complementary electronic control products.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies followed in the preparation of the Company s consolidated financial statements is set forth below:

Principles of Consolidation

The consolidated financial statements include the accounts and operations of Sun Hydraulics and its direct and indirect subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation. The Company uses the equity method of accounting to account for its investments in Sun China and WhiteOak. The Company does not have a majority ownership in or exercise control over either of the entities.

Critical Accounting Policies and Estimates

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

Revenue Recognition

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

Impairment of Long-Lived Assets

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

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

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Accounts Receivable

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

Inventory

The Company offers a wide variety of standard products and as a matter of policy does not discontinue products. On an ongoing basis, component parts found to be obsolete through design or process changes are disposed of and charged to material cost. The Company reviews on-hand balances of products and component parts against specific criteria. Products and component parts without usage or that have excess quantities on hand are evaluated. An inventory reserve is then established for the full inventory carrying value of those products and component parts deemed to be obsolete or slow moving. See Note 6 to the Financial Statements for inventory reserve amounts.

Goodwill

The Company acquired its Korean operations in September 1998 using the purchase method. As a result, goodwill is reflected on the consolidated balance sheet. A valuation based on the cash flow method was performed at December 30, 2006 and December 31, 2005. It was determined that the value of the goodwill was not impaired. There is no assurance that the value of the acquired company will not decrease in the future due to changing business conditions. See Note 8 to the Financial Statements for goodwill amounts.

Accruals

The Company makes estimates related to certain employee benefits and miscellaneous accruals. Estimates for employee benefit accruals are based on information received from plan administrators in conjunction with management s assessments of estimated liabilities related to workers compensation, health care benefits and annual contributions to an employee stock ownership plan (ESOP), established in 2004 as part of the Company s retirement plan. Estimates for miscellaneous accruals are based on management s assessment of estimated liabilities for costs incurred.

As of July 1, 2003, the Company accrues for health care benefit costs under a self-funded plan utilizing estimates provided by a third party administrator and insurance company. The Company purchases re-insurance for both specific and aggregate stop losses on claims that exceed $85,000 on an individual basis and approximately $4.8 million on an aggregate basis.

Stock Split

On June 10, 2005, the Company declared a three-for-two stock split, effected in the form of a 50% stock dividend, to shareholders of record on June 30, 2005, payable on July 15, 2005. The Company issued approximately 3,600,000 shares of common stock as a result of the stock split. The effect of the stock split on outstanding shares, earnings per share and dividends per share has been retroactively applied to all periods presented.

Management Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

52-53 Week Fiscal Year

The Company reports on a fiscal year that ends on the Saturday closest to December 31st. Each quarter generally consists of two 4-week periods and one 5-week period. As a result of the 2005 fiscal year ending December 31, 2005, the quarter-ended April 2, 2005 consisted of one 4-week period and two 5-week periods, resulting in a 53-week year.

Cash and Cash Equivalents

The Company considers all short-term highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Inventories

Inventories are valued at the lower of cost or market, cost being determined on a first-in, first-out basis. Obsolete and slow moving inventory is evaluated and reserves are established based on specific criteria determined by management.

Property, Plant and Equipment

Property, plant and equipment is stated at cost. Expenditures for repairs and improvements that significantly add to the productive capacity or extend the useful life of an asset are capitalized. Repairs and maintenance are expensed as incurred. Depreciation is computed using the straight line method over the following useful lives:

	Years
Computer equipment	3 - 5
Machinery and equipment	4 - 12
Furniture and fixtures	4 - 10
Leasehold and land improvements	5 - 15
Buildings	40

Gains or losses on the retirement, sale, or disposition of property, plant, and equipment are reflected in the Consolidated Statement of Operations in the period in which the assets are taken out of service.

Valuation Assessment of Long-Lived Assets

Management periodically evaluates long-lived assets for potential impairment and will provide for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be fully recoverable. Assets are reviewed for utilization on a monthly basis by management in conjunction with employees who work directly with the assets.

Goodwill

Goodwill, which represents the excess of the purchase price of acquisition over the fair value of the net assets acquired and other acquisition costs, is carried at cost. In accordance with FAS 142, goodwill is not amortized by the Company. Instead, FAS 142 requires goodwill to be reviewed for impairment on an annual basis, or more frequently if events or circumstances indicate possible impairment.

Other Assets

Other assets consist of equity investments in the Company s joint ventures in China and WhiteOak. The equity investments were recorded at cost and have been adjusted for investment income or loss and dividend distributions for each quarterly period since their origin.

Revenue Recognition

Sales are recognized when products are shipped and title to the products is passed to the customer. Sales incentives are granted to customers based upon the volume of purchases. These sales incentives are recorded at the time of sales as a reduction of gross sales.

Shipping and Handling Costs

Shipping and handling costs billed to distributors and customers are recorded in revenue. Shipping costs incurred by the Company are recorded in cost of goods sold.

Foreign Currency Translation and Transactions

The Company follows the translation policy provided by FAS No. 52, *Foreign Currency Translation*. The Pound Sterling is the functional currency of Sun Ltd. The Euro is the functional currency of Sun GmbH. The South Korean Won is the functional currency of Sun Korea. The U.S. Dollar is the functional currency for Sun Hydraulics and the reporting currency for the consolidated group. The assets and liabilities of Sun Ltd., Sun GmbH, and Sun Korea are translated at the exchange rate in effect at the balance sheet date, and income and expense items are translated at the average annual rate of exchange for the period. The resulting unrealized translation gains and losses are included as a component of shareholders equity designated as accumulated other comprehensive income. Realized gains and losses from foreign currency transactions are included in the Consolidated Statement of Operations.

Income Taxes

The Company follows the income tax policy provided by FAS No. 109, Accounting for Income Taxes (FAS 109). This Statement provides for a liability approach under which deferred income taxes are provided for based upon enacted tax laws and rates applicable to the periods in which the taxes become payable. These differences result from items reported differently for financial reporting and income tax purposes, primarily depreciation, accrued expenses and reserves.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standard (FAS) No. 123R, *Share-Based Payment*, (FAS 123R) for its share-based compensation plans. The Company previously accounted for these plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB 25) and related interpretations and disclosure requirements established by FAS No. 123, *Accounting for Stock-Based Compensation*, (FAS 123), as amended by FAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*.

Under APB 25, no compensation expense was recorded in earnings for the Company s stock options and awards granted under the Company s employee stock purchase plan (ESPP). The pro forma effects on net income and earnings per share for stock options were instead disclosed in a footnote to the financial statements. Compensation expense was recorded in earnings for restricted stock awards. Under FAS 123R, all share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense in earnings over the requisite service period.

The Company adopted FAS 123R using the modified prospective method. Under this transition method, compensation cost recognized in fiscal year 2006 includes the cost for all share-based awards granted prior to, but not yet vested as of January 1, 2006. This cost was based on the grant-date fair value estimated in accordance with the original provisions of FAS 123. Results for prior periods have not been restated.

The compensation cost for stock options will be based on the grant-date fair value of those awards as calculated using the Black-Scholes valuation model. Compensation for restricted stock awards is measured at fair value on the date of grant based on the number of shares expected to vest and the quoted market price of the Company s common stock. Compensation cost for stock options and restricted stock awards is recognized in earnings, net of estimated forfeitures, on a straight-line basis over the requisite service period. Compensation cost for shares granted under the ESPP is calculated based on actual quarterly purchases.

Prior to the adoption of FAS 123R, benefits of tax deductions in excess of recognized compensation costs were reported as operating cash flows. FAS 123R requires excess tax benefits be reported as a financing cash inflow rather than as a reduction of taxes paid.

3. ACQUISITIONS

On June 28, 2005, Sun Hydraulics acquired shares of common stock representing 40% of the outstanding shares of WhiteOak. WhiteOak designs and produces electronic amplifiers and other control products. The Company, together with WhiteOak, will co-develop products to be used in and in conjunction with other Company products. The acquisition price paid by the Company was $400. The excess paid over pro rata share of net assets of $270 is classified as developed technology and is being amortized over a period of 10 years.

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. The following methods and assumptions were used to estimate the fair value of each class of financial instruments.

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.

The carrying amount of long-term debt approximates fair value, as the interest rates on the debt approximate rates currently available to the Company for debt with similar terms and remaining maturities.

5. RESTRICTED CASH

On December 30, 2006 and December 31, 2005, the Company had restricted cash of $118 and $413, respectively. The restricted cash balance consisted of reserves for customs and excise taxes in the U.K. operation. The restricted amount was calculated as an estimate of two months of customs and excise taxes for items coming into the Company s U.K. operations and was held with Lloyd s TSB in the U.K.

6. INVENTORIES

	December 30, 2006	December 31, 2005
Raw materials	$ 3,585	$ 2,353
Work in process	3,481	2,988
Finished goods	3,715	2,767
Provision for slow moving inventory	(395)	(238)
Total	$ 10,386	$ 7,870

7. PROPERTY, PLANT, and EQUIPMENT

	December 30, 2006	December 31, 2005
Machinery and equipment	$ 60,244	$ 53,632
Office furniture and equipment	9,008	7,116
Buildings	25,477	22,347
Leasehold and land improvements	1,797	1,666
Land	2,940	2,759
	$ 99,466	$ 87,520
Less: Accumulated depreciation	(55,557)	(48,481)
Construction in progress	6,446	6,142
Total	$ 50,355	$ 45,181

Depreciation expense for the years ended December 30, 2006, December 31, 2005, and December 24, 2004 totaled $5,822, $5,591, and $5,465, respectively.

8. GOODWILL

On December 30, 2006 and December 31, 2005, the Company had $715 of goodwill related to its acquisition of Sun Korea.

Valuation models reflecting the expected future cash flow projections were used to value Sun Korea at December 30, 2006 and December 31, 2005. The analysis indicated that there was no impairment of the carrying value of the goodwill.

9. OTHER ASSETS

	December 30, 2006	December 31, 2005
Goodwill	$ 715	$ 715
Equity investment in joint venture		
Sun China	555	462
WhiteOak Controls, Inc.	80	117
Loan acquisition costs, net of amortization of $37 and $9	133	161
Developed technology, net of accumulated amortization of $40 and $13	230	257
Deposits with suppliers	73	73
Other	39	38
Total	$ 1,825	$ 1,823

On August 11, 2005, the Company completed a refinancing of its existing debt in the U.S. As a result of the refinancing, the Company wrote-off previously capitalized loan acquisition costs of $174. The new financing resulted in the capitalization of $170 of loan acquisition costs.

10. ACCRUED EXPENSES AND OTHER LIABILITIES

	December 30, 2006	December 31, 2005
Compensation and benefits	$ 2,353	$ 2,259
Insurance	866	806
Other	840	792
Total	$ 4,059	$ 3,857

11. LONG-TERM DEBT

	December 30, 2006	December 31, 2005
$35,000 revolving line of credit, collateralized by U.S. assets, interest rate Libor + 1.5% or Bank s Base Rate at Company s discretion, due August 1, 2011.	$	$ 999
$2,400 12-year mortgage note on the German facility, fixed interest rate of 6.05%, due September 30, 2008.	464	623
10-year notes, fixed interest rates ranging from 3.5-5.1%, collateralized by equipment in Germany, due between 2009 and 2011.	593	707
Other	15	55
	1,072	2,384
Less amounts due within one year	(426)	(398)
Total	$ 646	$ 1,986

The remaining principal payments are due as follows: 2007 $426; 2008 $390; 2009 $138; 2010 $88; 2011 and thereafter $30.

On August 11, 2005, the Company completed a refinancing of its existing debt in the U.S. with Fifth Third Bank (the Bank). The new financing consists of a secured revolving line of credit of $35 million (the Line of Credit). The Line of Credit is secured by the Company s U.S. assets, including its manufacturing facilities, and requires monthly payments of interest. The Line of Credit has a floating interest rate based upon the Company s leverage ratio. The Line of Credit is payable in full on August 1, 2011, but 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. At December 30, 2006, there was no outstanding balance on the Line of Credit.

The Line of Credit is subject to debt covenants including: 1) Debt (as defined) to Tangible Net Worth (as defined) ratio of not more than 1.5:1.0, 2) Funded Debt (as defined) to EBITDA (as defined) ratio of not more than 2.5:1.0, and 3) EBIT (as defined) to Interest Expense (as defined) ratio of not less than 1.1:1.0; and requires the Company to maintain its primary domestic deposit accounts with the Bank. As of December 30, 2006, the Company was in compliance with all debt covenants.

12. DIVIDENDS TO SHAREHOLDERS

The Company declared dividends of $4,345, $3,269, and $1,482 to shareholders in 2006, 2005, and 2004, respectively.

The Company declared the following quarterly dividends to shareholders of record on the last day of the respective quarter:

	2006	2005	2004
First quarter	$ 0.100	$ 0.050	$ 0.027
Second quarter	0.100	0.050	0.033
Third quarter	0.100	0.100	0.033
Fourth quarter	0.100	0.100	0.050

These dividends were paid on the 15th day of each month following the date of declaration. In addition, the Company declared a 50% stock dividend on June 30, 2005.

13. INCOME TAXES

Deferred income tax assets and liabilities are provided to reflect the future tax consequences of differences between the tax basis of assets and liabilities and their reported amounts in the financial statements.

For financial reporting purposes, income before income taxes includes the following components:

	For the year ended		
	December 30, 2006	December 31, 2005	December 25, 2004
United States	$ 16,341	$ 12,827	$ 7,865
Foreign	8,562	6,310	3,867
Total	$ 24,903	$ 19,137	$ 11,732

The components of the income tax provision (benefit) are as follows:

	For the year ended		
	December 30, 2006	December 31, 2005	December 25, 2004
Current tax expense:			
United States	$ 5,355	$ 5,038	$ 2,318
State and local	269	158	195
Foreign	2,730	1,821	1,251
Total current	8,354	7,017	3,764
Deferred tax expense (benefit):			
United States	324	(601)	112
State and local	(7)	(136)	24
Foreign	9	49	2
Total deferred	326	(688)	138
Total income tax provision	$ 8,680	$ 6,329	$ 3,902

The reconciliation between the effective income tax rate and the U.S. federal statutory rate is as follows:

	For the year ended		
	December 30, 2006	December 31, 2005	December 25, 2004
U.S. federal taxes at statutory rate	$ 8,467	$ 6,507	$ 3,966
Increase(decrease)			
Net residual tax on foreign distributions	169	264	
Foreign tax credit			(309)
Benefit of ETI exclusion	(217)	(170)	(136)
Domestic production activity deduction	(110)	(121)	
Foreign income taxed at lower rate	(172)	(64)	(38)
Change in foreign valuation allowance		(212)	
Nondeductible items			200
Benefit of state rate change		(118)	
Other	281	104	
State and local taxes, net	262	139	219

Income tax provision	$ 8,680	$ 6,329	$ 3,902

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income taxes. The temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of December 30, 2006 and December 31, 2005 are presented below:

	December 30, 2006	December 31, 2005
Deferred tax assets:		
Current:		
Accrued expenses and other	$ 219	$ 263
Foreign tax credit carryforward		437
Deferred royalty income		82
Total current deferred tax assets	219	782
Noncurrent:		
Accrued expenses and other	88	
Deferred royalty income	64	
Total noncurrent deferred tax assets	152	
Deferred tax liabilities:		
Noncurrent:		
Depreciation	(4,521)	(4,688)
Other	(82)	
Total noncurrent deferred tax liabilities	(4,603)	(4,688)
Net noncurrent deferred tax liability	$ (4,451)	$ (4,688)

A valuation allowance to reduce the deferred tax assets reported is required if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. For the fiscal years ended 2006 and 2005, management has determined that a valuation allowance is not required.

The Company intends to indefinitely reinvest the earnings of its non-U.S. subsidiaries, which reflect full provision for non-U.S. income taxes, to expand its international operations. These earnings relate to ongoing operations and, at December 30, 2006, cumulative earnings were approximately $17 million. Accordingly, no provision has been made for U.S. income taxes that might be payable upon repatriation of such earnings. In the event any earnings of non-U.S. subsidiaries are repatriated, the Company will provide U.S. income taxes upon repatriation of such earnings, which will be offset by applicable foreign tax credits, subject to certain limitations. During the years ended December 30, 2006 and December 31, 2005, the Company repatriated $5.0 million and $4.6 million, respectively, from its foreign subsidiaries. U.S. income taxes due based on the repatriations have been provided for in the above income tax provisions.

14. STOCK OPTION PLANS

The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair-value recognition provisions of FAS 123 to all of its share-based compensation awards for periods prior to the adoption of FAS 123R. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions as set forth below.

	December 31, 2005	December 25, 2004
Net Income as Reported	$ 12,808	$ 7,830
Stock-based compensation reported in net income, net of related taxes	215	165
Stock compensation expense calculated under FAS 123, net of related taxes	(336)	(256)
Pro Forma Net Income	$ 12,687	$ 7,739
Basic net income per common share:		
As reported	$ 1.18	$ 0.76
Pro forma	$ 1.17	$ 0.75
Diluted net income per common share:		
As reported	$ 1.17	$ 0.76
Pro forma	$ 1.16	$ 0.75
Assumptions		
Risk-free interest rate	4.54%	4.22%
Expected lives (in years)	6.5	6.5
Expected volatility	35.71%	40.00%
Dividend yield	1.83%	1.89%

During 1996, the Company adopted the 1996 Stock Option Plan (the Stock Option Plan), which provides for the grant of incentive stock options and nonqualified stock options for the purchase of up to an aggregate of 1,500,000 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.

A summary of the Company s stock option plan for the years ended December 30, 2006, December 31, 2005, and December 25, 2004 is summarized as follows:

	Number of shares	Exercise price range	Weighted average exercise price
	(share amounts are in thousands)		
Under option, December 27, 2003 (569 shares exercisable)	734	$ 2.00 - 11.17	$ 5.69
Granted	36	$ 8.23 - 8.23	$ 8.23
Exercised	(283)	$ 2.00 - 11.17	$ 5.91
Forfeitures	(14)	$ 4.50 - 6.67	$ 6.10
Under option, December 25, 2004 (335 shares exercisable)	473	$ 4.00 - 11.17	$ 6.51
Granted	4	$ 18.41 - 18.41	$ 18.41
Exercised	(370)	$ 4.00 - 11.17	$ 6.70
Forfeitures			
Under option, December 31, 2005 (41 shares exercisable)	107	$ 4.50 - 18.41	$ 6.36
Granted		$ -	$
Exercised	(31)	$ 4.50 - 8.23	$ 5.41
Forfeitures	(1)	$ 8.23 - 8.23	$ 8.23
Under option, December 30, 2006 (56 shares exercisable)	75	$ 4.50 - 18.41	$ 6.70

All options listed above vest over three to five years with a maximum term of seven to ten years.

A summary of outstanding and exercisable options at December 31, 2006 is summarized as follows:

	Options Outstanding			Options Exercisable	
		Weighted-average			
Range of exercise prices	Number of shares	Remaining contractual life	Exercise price	Number of shares	Weighted average exercise price
$ 4.50	8	3.83	4.50	8	4.50
4.67	11	4.83	4.67	11	4.67
4.73	21	3.75	4.73	21	4.73
5.33	2	3.67	5.33	2	5.33
5.51	5	5.42	5.51		5.51
8.23	24	4.75	8.23	13	8.23
18.41	5	5.92	18.41	1	18.41

The weighted average estimated fair value of stock options granted during 2005 and 2004 was $6.67 and $3.72 per share, respectively. There were no stock options granted during 2006.

In September 2006, the Company adopted the 2006 Stock Option Plan (2006 Plan), which provides for the grant of incentive stock options and nonqualified stock options for the purchase of up to an aggregate of 500,000 shares of the Company s common stock by officers, employees and directors of the Company. The Company adopted the 2006 Plan due to the expiration of the Company s 1996 Stock Option Plan in 2006. 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, and any awards granted prior to the 2007 Annual Meeting will be conditioned upon stockholder approval of the 2006 Plan at such meeting.

During 2001, the Company adopted the 2001 Restricted Stock Plan, which provides for the grant of restricted stock of up to an aggregate of 412,500 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. Restricted stock granted prior to January 1, 2006, was accounted for using the measurement and recognition principles of APB 25. Accordingly, compensation cost was 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 years ended December 30, 2006, December 31, 2005, and December 25, 2004 totaled $413, $342, and $250, respectively. At December 30, 2006, 128,040 shares remained available to be issued through the Restricted Stock Plan.

A summary of the Company s restricted stock plan for the years ended December 30, 2006, December 31, 2005, and December 25, 2004 is summarized as follows:

	Number of shares	Weighted average grant-date fair value
Nonvested balance at December 27, 2003	144	$ 4.95
Granted	36	8.23
Vested	(50)	4.91
Forfeitures	(1)	4.94
Nonvested balance at December 25, 2004	129	$ 5.85
Granted	26	18.41
Vested	(53)	5.66
Forfeitures	(7)	4.83
Nonvested balance at December 31, 2005	95	$ 9.45
Granted	30	20.22
Vested	(61)	7.38
Forfeitures	(2)	12.32
Nonvested balance at December 30, 2006	62	$ 16.71

The Company has $914 of total unrecognized compensation cost related to restricted stock awards granted under the Plan as of December 30, 2006. That cost is expected to be recognized over a weighted average period of 1.95 years. Pursuant to FAS 123R, the $741 of unearned compensation recorded as a reduction to stockholders equity as of December 31, 2005, was reversed against the Company s additional paid-in-capital.

During 2001, the Company adopted the Employee Stock Purchase Plan (ESPP), which became effective August 1, 2001. Most employees are eligible to participate. Employees 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. The ESPP authorizes the issuance, and the purchase by employees, of up to 487,500 shares of common stock through payroll deductions. No employee is allowed to buy more than $25,000 of common stock in any year, based on the market value of the common stock at the beginning of the purchase period. Employees purchased approximately 13,789 shares at an average price of $17.08 and 12,017 shares at an average price of $14.72, under the ESPP during 2006 and 2005, respectively. The Company recognized $48 of compensation expense during 2006 in accordance with FAS 123R. At December 30, 2006, 401,152 shares remained available to be issued through the ESPP.

During 2004, the Board of Directors adopted and the shareholders approved the Nonemployee Director Equity and Deferred Compensation Plan (the Plan). Directors who are not officers of the Company are paid $4,000 for attendance at each meeting of the Board of Directors, as well as each meeting of each Board Committee on which they serve when the committee meeting is not held within one day of a meeting of the Board of Directors. Directors receive $1,500 of the $4,000 Director fee in shares of Company stock under the Plan. Directors also may elect under the Plan to receive all or part of the remainder of their fees in Company stock and to defer receipt of their fees until a subsequent year. The Plan authorizes the issuance of up to 120,000 shares of common stock.

On September 9, 2006, the board approved an increase in the total amount paid for each such meeting to $5,000, and also amended the 2004 Plan to make $2,500 of the $5,000 fee payable in shares of the company s common stock. The amendment to the 2004 Plan is subject to approval by the company s stockholders at the 2007 Annual Meeting. If stockholder approval is not obtained at the 2007 Annual Meeting, the additional $1,000 will be paid in cash instead of shares, and the amendment to the 2004 Plan will automatically terminate.

Directors were granted 2,839 and 3,561 shares during 2006 and 2005, respectively. Of the shares granted in 2006, 283 shares are subject to shareholder approval. At December 30, 2006, there were 5,853 deferred stock units outstanding. Deferred stock units are treated as liabilities in accordance with FAS 123R. At December 30, 2006, 110,312 shares remained available to be issued through the Plan.

15. STOCK REPURCHASE PLANS

In June 2006, the Company s Board of Directors authorized the repurchase of up to $2.5 million of Company stock, to be completed no later than January 15, 2007. The stock purchases were made in the open market. Market purchases were made subject to restrictions relating to volume, price and timing in an effort to minimize the impact of the purchases on the market for the Company s securities. The amount of the stock repurchased was used to continue to fund the Company s employee stock ownership and employee stock purchase plans. Under the plan, which was completed in July, the Company had repurchased 135,382 shares at an average price of $18.47. All shares were retired during the year.

In December 2005, the Company s Board of Directors authorized the repurchase of up to $2.0 million of Company stock, to be completed no later than January 15, 2007. The stock purchases were made in the open market. Market purchases were made subject to restrictions relating to volume, price and timing in an effort to minimize the impact of the purchases on the market for the Company s securities. The amount of the stock repurchases was set based upon the anticipated number of shares that were required to fund the Company s ESOP, and employee stock purchase plan, through fiscal year 2006. The Company had repurchased 82,500 shares at an average cost of $18.87 per share and 22,698 shares at an average cost of $19.52 for the periods ending December 31, 2005 and December 30, 2006, respectively. Of the 82,500 shares purchased in 2005, 65,000 were retired prior to December 31, 2005. All remaining shares and purchases were retired during 2006.

In November 2004, the Company s Board of Directors authorized the repurchase of up to $2.5 million of Company stock, to be completed no later than January 15, 2006. The amount of the stock repurchases was set based upon the anticipated number of shares that were required to fund the Company s ESOP, and employee stock purchase plan, through fiscal year 2005. The Company purchased 8,700 shares at an average cost of $9.52 per share and 2,700 shares at an average cost of $9.80 per share for the periods ending December 25, 2004 and December 31, 2005, respectively. The stock purchases were made in the open market. Market purchases were made subject to restrictions relating to volume, price and timing in an effort to minimize the impact of the purchases on the market for the Company s securities. All shares were retired during the year of purchase.

16. EARNINGS PER SHARE

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

	December 30, 2006	December 31, 2005	December 25, 2004
Net income	**$ 16,223**	**$ 12,808**	**$ 7,830**
Basic weighted average number of common shares outstanding	10,878	10,827	10,269
Basic net income per common share	**$ 1.49**	**$ 1.18**	**$ 0.76**
Effect of dilutive stock options	61	91	77
Diluted weighted average number of common shares outstanding	10,939	10,918	10,346
Diluted net income per common share	**$ 1.48**	**$ 1.17**	**$ 0.76**

Diluted net income per common share excludes antidilutive stock options of approximately 67,500 during 2004.

17. EMPLOYEE BENEFITS

The Company has a defined contribution retirement plan covering substantially all of its eligible United States employees. Employer contributions under the retirement plan amounted to approximately $2,452, $2,205, and $2,346 during 2006, 2005, and 2004, respectively.

The Company provides supplemental pension benefits to its employees of foreign operations in addition to mandatory benefits included in local country payroll tax statutes. These supplemental pension benefits amounted to approximately $425, $437, and $437 during 2006, 2005, and 2004, respectively.

In June 2004, the Company s Board of Directors approved the establishment of an Employee Stock Ownership Plan (ESOP) as the discretionary match portion of its 401(k) retirement plan. Prior to 2004, discretionary matches to the 401(k) plan were made in cash. The Company contributes to the ESOP for all eligible United States employees. Under the ESOP, which is 100% company funded, the Company allocates common stock to each participants account. The allocation is generally a percentage of a participant s compensation as determined by the Board of Directors on an annual basis. The ESOP is accounted for under Statement of Position 93-6 *Employer s Accounting for Employee Stock Ownership Plans*.

In September 2004, the Company made an initial one-time contribution of 48,000 shares of its common stock to the ESOP. The Company made annual contributions to the ESOP of 68,659, 57,746, and 109,935 shares in January of 2007, 2006 and 2005, related to fiscal years 2006, 2005 and 2004, respectively. Contributions were based on annual compensation. All shares receive regular quarterly dividends payable to the ESOP to cover plan expenses.

The Company incurred compensation expense under the ESOP of approximately $1,407, $1,180 and $1,572 during 2006, 2005 and 2004, respectively.

Beginning January 1, 2007, there are no restrictions on the shares contributed to the ESOP. This allows participants to sell their shares to enable diversification within their individual 401(k) accounts. The Company does not have any repurchase obligations under the ESOP.

The Company awards deferred cash bonuses to key employees of its foreign operations. The deferred cash bonuses are similar to phantom stock units, in that such bonuses are tied to the value of the Company s common stock. Awards are recognized over the deferral period as variable plan awards. The Company recognized approximately $219 and $181 of compensation expense in 2006 and 2005, respectively, related to the awards.

18. 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, Korea, and France. Amounts for France, due to their immateriality, are included with the U.S. 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	United Kingdom	Germany	Elimination	Consolidated
2006						
Sales to unaffiliated customers	$ 89,077	$ 16,368	$ 17,709	$ 19,128	$	$ 142,282
Intercompany sales	25,809		2,990	106	(28,905)	
Operating income	16,608	2,212	2,330	4,046	(145)	25,051
Identifiable assets	59,505	7,580	13,756	8,187	(1,843)	87,185
Depreciation and amortization	4,206	150	983	510		5,849
Capital expenditures	8,408	122	757	238		9,525
2005						
Sales to unaffiliated customers	$ 73,998	$ 11,604	$ 16,054	$ 15,101	$	$ 116,757
Intercompany sales	21,239		2,873	80	(24,192)	
Operating income	13,443	1,520	1,260	3,145	(188)	19,180
Identifiable assets	50,019	4,958	12,403	8,777	(2,596)	73,561
Depreciation and amortization	3,944	149	1,025	473		5,591
Capital expenditures	7,007	29	934	843		8,813
2004						
Sales to unaffiliated customers	$ 59,847	$ 8,723	$ 13,375	$ 12,558	$	$ 94,503
Intercompany sales	15,702		1,812	66	(17,580)	
Operating income	8,417	926	483	2,399	69	12,294
Identifiable assets	44,765	4,449	13,742	10,062	(1,210)	71,808
Depreciation and amortization	3,792	137	1,061	475		5,465
Capital expenditures	4,264	42	540	141		4,987

Operating income is total sales and other operating income less operating expenses. Segment operating income does not include interest expense, foreign currency transaction gain/loss, and net miscellaneous income/expense.

Included in U.S. sales to unaffiliated customers were export sales of $23,110, $15,353, and $12,147, during 2006, 2005, and 2004, respectively. Export sales to Canada and Asia/Pacific totaling, $15,853, $12,681, and $10,162, during 2006, 2005, and 2004, respectively, make up the majority of these export sales.

19. 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.

OPERATING LEASES The Company leases a manufacturing facility in Lenexa, Kansas and production support facilities in Sarasota, Florida under operating leases having initial terms expiring between 2007 and 2008. The lease for the manufacturing facility in Kansas has a term of 5 years, expiring on November 14, 2008, and represents approximately 17,000 square feet of space. The leases for the production support facilities in Florida range from one to two years and represent approximately 10,000 square feet. Total rental expense for the years ended December 30, 2006, 2005 and 2004 was approximately $226, $182 and $172, respectively.

Future minimum lease payments on operating leases are as follows:

2007	$ 210
2008	128
Total minimum lease payments	$ 338

INSURANCE On July 1, 2003, the Company changed its group health insurance plan that covers U.S. employees and their families from a fully-insured policy to a self-funded plan. The Company purchases re-insurance for both specific and aggregate stop losses on claims that exceed $85,000 on an individual basis and approximately $4.8 million on an aggregate basis. The Company records a liability for all unresolved claims at the anticipated cost to the Company at the end of the period based on the estimates provided by a third party administrator and insurance company, plus an estimate for amounts incurred but not recorded. The Company believes it has adequate reserves for all self-insurance claims.

20. NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued FAS No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting this Statement.

In July 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes, and Related Implementation Issues* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a Company s financial statements in accordance with FASB No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective as of the beginning of fiscal years that begin after December 15, 2006. The adoption of this Statement is not expected to have a material effect on the Company s Consolidated Financial Statements.

In March 2006, the FASB issued FAS No.156, *Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140* (FAS 156), that provides guidance on accounting for separately recognized servicing assets and servicing liabilities. In accordance with the provisions of FAS No. 156, separately recognized servicing assets and servicing liabilities must be initially measured at fair value, if practicable. Subsequent to initial recognition, the Company may use either the amortization method or the fair value measurement method to account for servicing assets and servicing liabilities within the scope of this Statement. FAS 156 is effective for fiscal years beginning after September 15, 2006. The adoption of this Statement is not expected to have a material effect on the Company s Consolidated Financial Statements.

In February 2006, the FASB issued FAS No.155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140* (FAS 155), to permit fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation in accordance with the provisions of FAS No.133, *Accounting for Derivative Instruments and Hedging Activities*. FAS 155 is effective for fiscal years beginning after September 15, 2006. The adoption of this Statement is not expected to have a material effect on the Company s Consolidated Financial Statements.

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 March 19, 2007.

SUN HYDRAULICS CORPORATION

By: /s/ Allen J. Carlson
Allen J. Carlson, President and
Chief Executive Officer