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 July 3, 2010

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	**(I.R.S. Employer**

Incorporation or Organization)	**Identification No.)**
1500 WEST UNIVERSITY PARKWAY **SARASOTA, FLORIDA**	**34243**
(Address of Principal Executive Offices)	**(Zip Code)**

941/362-1200

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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	x
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 x

The Registrant had 16,959,759 shares of common stock, par value $.001, outstanding as of July 30, 2010.

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Sun Hydraulics Corporation

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For the quarter ended July 3, 2010

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PART I: FINANCIAL INFORMATION

Item 1.

Sun Hydraulics Corporation

Consolidated Balance Sheets

(in thousands, except share data)

	July 3, 2010 (unaudited)	January 2, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 27,860	$ 30,314
Restricted cash	124	132
Accounts receivable, net of allowance for doubtful accounts of $77 and $90	16,596	9,949
Inventories	9,300	7,799
Income taxes receivable		1,485
Deferred income taxes	575	575
Marketable securities	13,352	7,844
Other current assets	2,733	1,797
Total current assets	70,540	59,895
Property, plant and equipment, net	53,644	56,633
Other assets	2,840	3,405
Total assets	**$ 127,024**	**$ 119,933**
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable	$ 4,743	$ 2,442
Accrued expenses and other liabilities	3,205	2,475
Income taxes payable	174	
Dividends payable	1,526	1,524
Total current liabilities	9,648	6,441
Deferred income taxes	5,173	5,191
Other noncurrent liabilities	650	687
Total liabilities	15,471	12,319
Commitments and contingencies		
Shareholders equity:		
Preferred stock, 2,000,000 shares authorized, par value $0.001, no shares outstanding		
Common stock, 20,000,000 shares authorized, par value $0.001, 16,959,759 and 16,933,168 shares outstanding	17	17
Capital in excess of par value	43,015	42,210
Retained earnings	70,750	64,383
Accumulated other comprehensive income (loss)	(2,229)	1,004

Total shareholders equity	111,553	107,614
Total liabilities and shareholders equity	**$ 127,024**	**$ 119,933**

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

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Sun Hydraulics Corporation

Consolidated Statements of Operations

(in thousands, except per share data)

	Three months ended July 3, 2010 (unaudited)	Three months ended June 27, 2009 (unaudited)
Net sales	**$ 39,246**	**$ 21,607**
Cost of sales	25,262	17,373
Gross profit	**13,984**	**4,234**
Selling, engineering and administrative expenses	4,845	4,867
Operating income (loss)	**9,139**	**(633)**
Interest income, net	(144)	(171)
Foreign currency transaction loss, net	69	339
Miscellaneous (income) expense, net	(109)	101
Income (loss) before income taxes	**9,323**	**(902)**
Income tax provision (benefit)	3,210	(366)
Net income (loss)	**$ 6,113**	**$ (536)**
Basic net income (loss) per common share	**$ 0.36**	**$ (0.03)**
Weighted average basic shares outstanding	16,953	16,867
Diluted net income (loss) per common share	**$ 0.36**	**$ (0.03)**
Weighted average diluted shares outstanding	16,985	16,899
Dividends declared per share	**$ 0.090**	**$ 0.090**

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

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Sun Hydraulics Corporation

Consolidated Statements of Operations

(in thousands, except per share data)

	Six months ended July 3, 2010 (unaudited)	Six months ended June 27, 2009 (unaudited)
Net sales	**$ 70,850**	**$ 46,815**
Cost of sales	46,747	37,003
Gross profit	**24,103**	**9,812**
Selling, engineering and administrative expenses	10,001	9,642
Operating income	**14,102**	**170**
Interest income, net	(281)	(282)
Foreign currency transaction loss, net	41	331
Miscellaneous (income) expense, net	(128)	300
Income (loss) before income taxes	**14,470**	**(179)**
Income tax provision (benefit)	5,047	(194)
Net income	**$ 9,423**	**$ 15**
Basic net income per common share	**$ 0.56**	**$ 0.00**
Weighted average basic shares outstanding	16,948	16,767
Diluted net income per common share	**$ 0.55**	**$ 0.00**
Weighted average diluted shares outstanding	16,981	16,797
Dividends declared per share	**$ 0.180**	**$ 0.270**

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

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Sun Hydraulics Corporation

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

(in thousands)

	Preferred shares	Preferred stock	Common shares	Common stock	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income	Total
Balance, January 2, 2010		$	16,933	$ 17	$ 42,210	$ 64,383	$ 1,004	$ 107,614
Shares issued, stock options			10		39			39
Shares issued, ESPP			16		176			176
Stock-based compensation			1		61			61
Shares issued, restricted stock					500			500
Tax benefit of stock-based compensation					29			29
Dividends declared						(3,056)		(3,056)
Comprehensive income:								
Net income						9,423		9,423
Foreign currency translation adjustments							(3,063)	(3,063)
Unrealized loss on available-for-sale securities							(170)	(170)
Comprehensive income								6,190
Balance, July 3, 2010		$	16,960	$ 17	$ 43,015	$ 70,750	$ (2,229)	$ 111,553

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

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Sun Hydraulics Corporation

Consolidated Statements of Cash Flows

(in thousands)

	Six months ended	
	July 3, 2010 (unaudited)	**June 27, 2009 (unaudited)**
Cash flows from operating activities:		
Net income	$ 9,423	$ 15
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,460	3,559
Loss on disposal of assets	21	1
Provision for deferred income taxes	(18)	35
Allowance for doubtful accounts	(13)	(6)
Stock-based compensation expense	540	441
Stock options income tax benefit	(29)	
(Increase) decrease in:		
Accounts receivable	(6,634)	2,033
Inventories	(1,501)	1,563
Income taxes receivable	1,485	(2,057)
Other current assets	(936)	(326)
Other assets	549	277
Increase (decrease) in:		
Accounts payable	2,301	107
Accrued expenses and other liabilities	752	(200)
Taxes payable	203	
Other noncurrent liabilities	(37)	24
Net cash provided by operating activities	9,566	5,466
Cash flows from investing activities:		
Capital expenditures	(1,325)	(3,506)
Purchases of marketable securities	(11,126)	(8,133)
Proceeds from sale of marketable securities	5,390	420
Net cash used in investing activities	(7,061)	(11,219)
Cash flows from financing activities:		
Repayment of debt		(261)
Proceeds from exercise of stock options	39	214
Proceeds from stock issued	176	
Dividends to shareholders	(3,051)	(4,504)
Stock options income tax benefit	29	
Net cash used in financing activities	(2,807)	(4,551)
Effect of exchange rate changes on cash and cash equivalents	(2,160)	1,066
Net decrease in cash and cash equivalents	(2,462)	(9,238)
Cash and cash equivalents, beginning of period	**30,446**	**35,303**
Cash and cash equivalents, end of period	**$ 27,984**	**$ 26,065**

Supplemental disclosure of cash flow information:				
Cash paid:				
Interest	$		$	9
Income taxes	$	3,406	$	1,828

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

SUN HYDRAULICS CORPORATION

NOTES TO THE CONSOLIDATED, UNAUDITED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

1. BASIS OF PRESENTATION AND SUMMARY OF 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, China, and India. Sun Hydraulics Corporation (Sun Hydraulics), with its main offices located in Sarasota, Florida, designs, manufactures, and sells its products primarily through distributors. Sun Hydraulik Holdings Limited (Sun Holdings), a wholly-owned subsidiary of Sun Hydraulics, was formed to provide a holding company for the European market operations; its wholly-owned subsidiaries are Sun Hydraulics Limited (a British corporation, Sun Ltd.) and Sun Hydraulik GmbH (a German corporation, Sun GmbH). Sun Ltd. operates a manufacturing and distribution facility located in Coventry, England, and Sun GmbH operates a manufacturing and distribution facility located in Erkelenz, Germany. Sun Hydraulics Korea Corporation (Sun Korea), a wholly-owned subsidiary of Sun Hydraulics, located in Inchon, South Korea, operates a manufacturing and distribution facility. Sun Hydraulics, SARL (Sun France), a wholly-owned subsidiary of Sun Hydraulics, located in Bordeaux, France, 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. WhiteOak Controls, Inc. (WhiteOak), a 40% equity method investment, is located in Mediapolis, Iowa, and designs and produces complementary electronic control products. High Country Tek, Inc. (HCT), a 48% equity method investment, is located in Nevada City, California, and designs and manufacturers ruggedized electronic/hydraulic control solutions for mobile equipment markets. Sun Hydraulics also has a sales office in Bangalore, India, to develop new business opportunities in the Indian market.

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, 2010 filed by Sun Hydraulics Corporation (together with its subsidiaries, the Company) with the Securities and Exchange Commission on March 15, 2010. In Management s opinion, all adjustments necessary for a fair presentation of the Company s financial statements are reflected in the interim periods presented. Operating results for the three and six month periods ended July 3, 2010, are not necessarily indicative of the results that may be expected for the period ending January 1, 2011.

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		Six Months Ended	
	July 3, 2010	**June 27, 2009**	**July 3, 2010**	**June 27, 2009**
Net income	**$ 6,113**	**$ (536)**	**$ 9,423**	**$ 15**
Weighted average basic shares outstanding	16,953	16,867	16,948	16,767
Basic net income per common share	**$ 0.36**	**$ (0.03)**	**$ 0.56**	**$ 0.00**
Effect of dilutive stock options	32	32	33	30
Weighted average diluted shares outstanding	16,985	16,899	16,981	16,797
Diluted net income per common share	**$ 0.36**	**$ (0.03)**	**$ 0.55**	**$ 0.00**

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3. STOCK-BASED COMPENSATION

During 1996, the Company adopted the 1996 Stock Option Plan (1996 Plan), which provides for the grant of incentive stock options and nonqualified stock options for the purchase of up to an aggregate of 2,250,000 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 activity under the 1996 Plan for the six months ended July 3, 2010, is as follows:

	Number of shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Options outstanding as of January 2, 2010	16	$ 6.39		
Granted				
Exercised	(9)	$ 4.05		
Forfeitures				
Options outstanding as of July 3, 2010	7	$ 9.36	1.92	$ 96
Options exercisable as of July 3, 2010	6	$ 8.67	1.80	$ 82

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

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model using weighted average assumptions. Stock option compensation expense for both of the six month periods ended July 3, 2010, and June 27, 2009, was $3. There were no options granted during these periods.

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 750,000 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.

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During 2001, the Company adopted the 2001 Restricted Stock Plan, which provides for the grant of restricted stock of up to an aggregate of 618,750 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. 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 six months ended July 3, 2010, and June 29, 2009, totaled $408 and $388 respectively.

The following table summarizes restricted stock activity from January 2, 2010, through July 3, 2010:

	Number of shares	Weighted average grant-date fair value
Nonvested balance at January 2, 2010	75	21.78
Granted		
Vested		
Forfeitures		
Nonvested balance at July 3, 2010	75	21.78

The Company has $942 of total unrecognized compensation cost related to restricted stock awards granted under the Plan as of July 3, 2010. That cost is expected to be recognized over a weighted average period of 1.2 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 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 731,250 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 their annual salary in any year. Employees purchased 9,484 shares at a weighted average price of $19.46, and 14,302 shares at a weighted average price of $14.13, under the ESPP during the six months ended July 3, 2010, and June 27, 2009, respectively. The Company recognized $61 and $20 of compensation expense during the six months ended July 3, 2010, and June 27, 2009, respectively. At July 3, 2010, 530,222 shares remained available to be issued through the ESPP.

The Company has a Nonemployee Director Equity and Deferred Compensation Plan (the Plan), which originally was adopted by the Board of Directors and approved by the shareholders in 2004. The Plan was amended on March 1, 2008 and was approved by the shareholders at the 2008 Annual Meeting. Under the Plan, Directors who are not officers of the Company are paid 250 shares of Company common stock and $3 in cash fees for attendance at each meeting of the Board of Directors, as well as each meeting of each Board Committee on which they serve when the committee meeting is not held within one day of a meeting of the Board of Directors. Additionally, the Board of Directors has the authority to increase from time to time, as it deems desirable or appropriate, the number of shares of stock awarded to all or any one or more of the Nonemployee Directors. No more than 25,000 shares of stock, in the aggregate, may be issued under the Plan during any single calendar year. Committee Chairmen currently receive additional fees equal to 25% of normal compensation and the Chairman of the Board is paid twice the amount of normal compensation, with such additional compensation payable in Company common stock. Prior to June 2, 2008, under the Plan Nonemployee Directors were paid $5 of which half was paid in Company common stock.

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Directors may elect under the Plan to receive all or part of their cash fees in Company stock and to defer receipt of their fees until a subsequent year. When so deferred, the shares of stock are converted to deferred stock units. Deferred stock units are treated as liabilities. At July 3, 2010, there were 28,211 deferred stock units outstanding.

Directors were granted 5,278 and 5,218 shares for the six months ended July 3, 2010, and June 27, 2009, respectively. The Company recognized director stock compensation expense of $36 and $15 for the six months ended July 3, 2010, and June 27, 2009, respectively. The Plan authorizes the issuance of up to 180,000 shares of common stock. At July 3, 2010, 137,773 shares remained available to be issued through the Plan.

4. RESTRICTED CASH

The restricted cash balance at July 3, 2010, consisted of $46 in reserves as a required deferment for customs in the U.K. operation. The restricted amount was calculated as an estimate of two months of customs for items coming into the Company s U.K. operations and is held with Lloyd s TSB in the U.K. The remaining amount of $78 relates to a guarantee of VAT in our France operation. The guarantee is held with Crédit Agricole Bank in France.

5. INVENTORIES

	July 3, 2010	January 2, 2010
Raw materials	$ 3,884	$ 3,186
Work in process	3,147	2,420
Finished goods	2,914	2,900
Provision for slow moving inventory	(645)	(707)
Total	$ 9,300	$ 7,799

6. GOODWILL

On July 3, 2010, the Company had $715 of goodwill, related to its acquisition of Sun Korea. Goodwill is held in other assets on the balance sheet. Valuation models reflecting the expected future cash flow projections were used to value Sun Korea at January 2, 2010. The analysis indicated that there was no impairment of the carrying value of the goodwill. As of July 3, 2010, no factors were identified that indicated impairment of the carrying value of the goodwill.

7. LONG-TERM DEBT

The Company has a $35,000 revolving line of credit, collateralized by U.S. assets, with an interest rate of Libor plus 1.5% (1.848% at July 3, 2010), that comes due August 1, 2011. The Company did not have any debt outstanding for the periods ending July 3, 2010 and January 2, 2010.

The revolving line of credit is subject to debt covenants (capitalized terms are defined therein) including: 1) Debt to Tangible Net Worth ratio of not more than 1.5:1.0, 2) Funded Debt to EBITDA ratio of not more than 2.5:1.0, and 3) EBIT to Interest Expense 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 July 3, 2010, the Company was in compliance with all debt covenants.

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8. INCOME TAXES

At July 3, 2010, the Company had an unrecognized tax benefit of $506 including accrued interest, an increase of $121 from the prior period for uncertain tax positions related to previous years. If recognized, the unrecognized tax benefit would have a favorable effect on the effective tax rate in future periods. The Company recognizes interest and penalties related to income tax matters in income tax expense. Interest accrued as of July 3, 2010, is not considered material to the Company s Consolidated Financial Statements.

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

The Company s federal returns are currently under examination by the Internal Revenue Service (IRS) in the United States for the periods 2004 through 2007. The IRS proposed a significant adjustment to the Company s research and development tax credit position. Management has disagreed with the proposed adjustment and believes sufficient evidence is available to defend the position. To date, there have not been any other significant proposed adjustments.

Audit outcomes and the timing of audit settlements are subject to significant uncertainty. It is reasonably possible that within the next twelve months the Company will resolve some or all of the matters presently under consideration for 2004 through 2007 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. 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.

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Segment information is as follows:

	United States	Korea	Germany	United Kingdom	Elimination	Consolidated
Three Months						
Ended July 3, 2010						
Sales to unaffiliated customers	$ 25,259	$ 4,644	$ 4,669	$ 4,674	$	$ 39,246
Intercompany sales	6,785		28	287	(7,100)	
Operating income	7,005	651	911	759	(187)	9,139
Depreciation	1,320	22	102	234		1,678
Capital expenditures	515	48	1	92		656
Three Months						
Ended June 27, 2009						
Sales to unaffiliated customers	$ 12,569	$ 2,384	$ 3,445	$ 3,209	$	$ 21,607
Intercompany sales	3,544		46	233	(3,823)	
Operating income (loss)	(1,541)	124	561	123	100	(633)
Depreciation	1,365	27	130	260		1,782
Capital expenditures	2,205	4	24	37		2,270
Six Months						
Ended July 3, 2010						
Sales to unaffiliated customers	$ 44,228	$ 8,836	$ 9,368	$ 8,418	$	$ 70,850
Intercompany sales	11,882		81	625	(12,588)	
Operating income	9,875	1,277	2,028	1,095	(173)	14,102
Depreciation	2,648	44	214	484		3,390
Capital expenditures	1,081	113	5	125		1,324
Six Months						
Ended June 27, 2009						
Sales to unaffiliated customers	$ 28,189	$ 4,345	$ 7,612	$ 6,669	$	$ 46,815
Intercompany sales	7,700		75	698	(8,473)	
Operating income (loss)	(2,090)	210	1,274	576	200	170
Depreciation	2,735	53	254	493		3,535
Capital expenditures	3,336	27	28	115		3,506

Sales to unaffiliated customers represent sales from each of the individual subsidiaries. For information on sales to geographic locations, see the Comparison of the Three and Six Month Periods Ended July 3, 2010, and June 27, 2009, in Management s Discussion and Analysis of Financial Condition and Results of Operations. Operating income is total sales and other operating income less operating expenses. Segment operating income does not include interest income/expense, foreign currency transaction gain/loss, and net miscellaneous income/expense.

10. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

The Company held available-for-sale securities with an aggregate fair value of $13,352 and $490 at July 3, 2010, and June 27, 2009, respectively. The Company, on a recurring basis, measures available-for-sale

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securities at fair value using quoted prices in active markets. The net unrealized holding loss amounted to $54 at July 3, 2010, and $2 at June 27, 2009. In addition, the Company reports deferred director stock units and phantom stock units as a liability. These liabilities, on a recurring basis, are measured at fair value using quoted prices in the active market. The Company s liability was $676 and $430, at July 3, 2010, and June 27, 2009, respectively. The Company recognized a net gain related to those liabilities of $50 for the period ended July 3, 2010 and a net expense of $35 for the period ended June 27, 2009.

The Company did not have any fair value adjustments for assets and liabilities measured at fair value on a nonrecurring basis during the six months ended July 3, 2010 and June 27, 2009.

Assets measured at fair value on a recurring basis include the following as of July 3, 2010:

		Fair Value Measurements at Reporting Date Using		
Description	**July 3, 2010**	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available-for-sale securities	$ 13,352	$ 13,352	$	$

		Fair Value Measurements at Reporting Date Using		
Description	**July 3, 2010**	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Deferred director stock units	$ 646	$ 646	$	$
Phantom stock units	30	30		
Total	$ 676	$ 676	$	$

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.

11. NEW ACCOUNTING PRONOUNCEMENTS

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance amending the existing fair value measurements and disclosures guidance. The amendment requires new disclosures regarding the transfers in and out of level 1 and 2 fair value measurements and activity in level 3 fair value measurements. The amendment also clarifies existing disclosures regarding the level of disaggregated information as well as more disclosure around valuation techniques and inputs to fair value measurements. The guidance was effective for interim and annual reporting periods commencing after December 15, 2009, with a portion effective for fiscal years beginning after December 15, 2010. The adoption of this guidance has not had a material impact on the Company s Consolidated Financial Statements, nor is the remaining guidance expected to have a material impact.

12. 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.

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

Sun Hydraulics Corporation is a leading designer and manufacturer of high-performance screw-in hydraulic cartridge valves and manifolds, which control force, speed and motion as integral components in fluid power systems. The Company sells its products globally through wholly-owned subsidiaries and independent distributors. Sales outside the United States for the year ended January 2, 2010, were approximately 59% of total net sales.

Approximately two-thirds of product sales are used by the mobile market, which is characterized by applications where the equipment is not fixed in place, the operating environment is often unpredictable, and duty cycles are generally moderate to low. Some examples of the mobile market include equipment used in off-road construction, agriculture, fire and rescue, utilities, oil fields, and mining.

The remaining one-third of sales are used by industrial markets, which are characterized by equipment that is fixed in place, typically in a controlled environment, and which operates at higher pressures and duty cycles. Power units, automation machinery, metal cutting machine tools and plastics machinery are some examples of industrial equipment. The Company sells to both markets with a single product line.

Industry conditions

Demand for the Company s products is dependent on demand for the capital goods into which the products are incorporated. The capital goods industries in general, and the fluid power industry specifically, are subject to economic cycles. According to the National Fluid Power Association (the fluid power industry s trade association in the United States), the United States index of twelve-month shipments of hydraulic products decreased 40% and increased 8% in 2009 and 2008, respectively. The index of shipments of hydraulic products increased 56% for the three-month period ending July 3, 2010, compared to the same period of the prior year.

The Company s order trend has historically tracked closely to the United States Purchasing Managers Index (PMI). When PMI is over 50, it indicates economic expansion in the manufacturing sector; when it is below 50, it indicates contraction in the economy. The index increased to 56.2 in June 2010 compared to 44.8 in June 2009. In July 2010, the index was 55.5. July represents the twelfth consecutive month of expansion in the manufacturing sector. The rate of growth has slowed over the last three months, but remains solidly above 50. This indicates continued expansion in the economy, albeit at a slightly slower rate of growth.

Results for the second quarter

(Dollars in millions except net income per share)

	July 3, 2010	June 27, 2009	Increase
Three Months Ended			
Net Sales	$ 39.2	$ 21.6	81%
Net Income (loss)	$ 6.1	-$ 0.5	1320%
Net Income (loss) per share:			
Basic	$ 0.36	-$ 0.03	1300%
Diluted	$ 0.36	-$ 0.03	1300%
Six Months Ended			
Net Sales	$ 70.9	$ 46.8	51%
Net Income	$ 9.4	$ 0.0	62720%
Net Income per share:			
Basic	$ 0.56	$ 0.00	62496%
Fully Diluted	$ 0.55	$ 0.00	61490%

The Company had a strong second quarter, as management had expected. The Company met its revenue estimates, came in at the top of its earnings estimates, and quickly regained its operating leverage. The second quarter results included shipments to new customers in China, North America and Europe. Some of this new business represents sizeable ongoing orders for the Company. In all cases, management believes that its efforts last year during the downturn are the foundation of securing this new business. Management believes that the Company is operating at a high rate of efficiency. On-time deliveries are being maintained with a small amount of overtime and, to date, the Company has engaged in limited hiring in key areas.

Management believes that the Company has the infrastructure and capability in place to meet demand. The Company has proven that it is agile and can flex with the business cycle. Management believes that the Company s long term success will be the result of continued service to our existing customers, working diligently to gain new customers, and investing in employees and processes.

Outlook

Third quarter estimates reflect normal seasonality in demand levels. The Company typically has a strong second quarter followed by some softening in the third quarter and 2010 is following that same pattern. The Company is able to continue to demonstrate strong operating leverage on higher revenues.

The Company s 2010 third quarter sales are expected to be $37 million, a 59% increase in revenue compared to the same period last year, and earnings are expected to be $0.32 to $0.34 per share compared to $0.03 per share in the same period of the prior year.

COMPARISON OF THE THREE MONTHS ENDED JULY 3, 2010 AND JUNE 27, 2009

Net Sales

Net sales were $39.2 million, an increase of $17.6 million, or 81.6%, compared to $21.6 million in 2009. There was minimal impact on sales as a result of exchange rates. The increase in net sales was primarily driven by increased demand in our end markets, which primarily include capital goods equipment. New product sales (defined as products introduced within the last five years) generally make up 10 - 15% of total sales.

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North American sales increased 92.8% or $8.5 million, to $17.6 million, Asian sales increased 109.5% or $4.6 million, to $8.8 million, and European sales increased 49.1% or $3.7 million, to $11.3 million.

The U.S. reporting segment had sales of $25.3 million in the second quarter of 2010, up $12.7 million or 101.0%, compared to sales of $12.6 million during the second quarter last year. The increase was driven by demand in our end markets and the general upturn in the global economy. International sales out of the U.S. were $9.7 million during the second quarter of 2010, up 121.0% or $5.3 million, compared to $4.4 million during the second quarter last year. Significant increases in sales were noted in almost all geographic regions.

The Korean reporting segment had sales of $4.6 million during the second quarter of 2010, up $2.3 million or 94.8%, compared to sales of $2.4 million during the second quarter last year. Currency effect increased 2010 second quarter sales by approximately $0.4 million. The remaining increase is a result of efforts to expand and diversify its customer base, in addition to increased demand from existing customers.

The German reporting segment had sales of $4.7 million during the second quarter of 2010, up $1.2 million or 35.6%, compared to sales of $3.4 million during the second quarter last year. Currency effect decreased 2010 second quarter sales by approximately $0.3 million. The increase in sales was primarily related to demand within Germany and to Italy.

The U.K. reporting segment had sales of $4.7 million during the second quarter of 2010, up $1.5 million or 45.6%, compared to sales of $3.2 million during the second quarter last year. Currency effect decreased 2010 second quarter sales by approximately $0.1 million. The increase in sales was primarily related to demand within the U.K. and to Sweden, Finland, and France.

Gross Profit

Gross profit increased $9.8 million or 230.3% to $14.0 million in the second quarter of 2010, compared to $4.2 million in the second quarter last year. Gross profit as a percentage of net sales increased to 35.6% in the second quarter of 2010, compared to 19.6% in the second quarter last year.

During the downturn of the prior year, the Company maintained its workforce and labor and variable overhead costs became essentially fixed. By maintaining its workforce, the Company has been able to respond to the increasing demand. As sales increase across all segments, the Company is experiencing productivity improvements and is able to leverage its overhead costs to generate higher gross profit.

Higher sales volume in the second quarter of 2010 contributed $3.5 million of the increase. The remaining increase in gross profit was attributed to productivity improvements of approximately $1.7 million, and decreases in overhead expenses as a percentage of sales of approximately $5.0 million, both of which occurred primarily in the U.S. The increase in gross profit was partially offset by higher material costs as a percent of sales of approximately $0.4 million.

Selling, Engineering and Administrative Expenses

Selling, engineering and administrative expenses remained flat for the quarter at $4.8 million compared to the same quarter of the prior year. Increases in marketing efforts in Asia, and fringe benefit costs related to self-funded health plans in the U.S., were offset by decreases in salaries and outside services.

Operating Income (Loss)

Operating income increased $9.8 million or 1,543.8% to $9.1 million in the second quarter of 2010, compared to a loss of $0.6 million in the second quarter last year, with operating margins of 23.3% and (2.9)% for the second quarters of 2010 and 2009, respectively. Based on the Company s structure and decisions during the downturn, the increase in sales during the second quarter of 2010 has improved operating margins across all segments. During the downturn of the prior year, the Company maintained its workforce and labor and variable overhead costs became essentially fixed. By maintaining its workforce, the Company has been able to respond to the increasing demand. As sales increase across all segments, the Company is experiencing productivity improvements and is able to leverage its overhead costs to generate higher operating income.

The U.S. reporting segment contributed $7.0 million to our consolidated operating income during the second quarter of 2010, compared to an operating loss of $1.5 million during the second quarter of 2009, an increase of $8.5 million. The increase in the U.S. operating segments is primarily related to productivity gains and leverage of its overhead costs. Productivity gains contributed $1.8 million and decreases in variable and fixed overhead costs added $5.4 million to operating income. The remaining increases in operating income were from the absorption of selling, engineering, and administrative expenses which decreased $0.1 million in whole dollars.

The Korean reporting segment contributed $0.7 million to our consolidated operating income during the second quarter of 2010 compared to $0.1 million during the second quarter last year, an increase of $0.5 million. The increase in operating income was primarily related to material costs due to the strength of the Korean Won against the U.S. Dollar for material purchases made in U.S. Dollars of $0.2 million. The increase in sales volume resulted in $0.1 million of additional operating income.

The German reporting segment contributed $0.9 million to our consolidated operating income during the second quarter of 2010 compared to $0.6 million during the second quarter last year, an increase of $0.4 million. The increase was primarily related to absorption of fixed costs which added $0.4 million to operating income. The increase in sales volume resulted in $0.1 million of additional operating income. These amounts were offset by material costs, due to the weakening of the Euro against the U.S. Dollar for material purchases made in U.S. Dollars of $0.2 million.

The U.K. reporting segment contributed $0.8 million to our consolidated operating income during the second quarter of 2010 compared to $0.1 million during the second quarter last year, an increase of $0.6 million. The increase was primarily related to absorption of fixed costs adding $0.4 million to operating income, and productivity improvements of $0.2 million. These amounts were partially offset by increased material costs of $0.1 million.

Interest Income, Net

Net interest income was $0.1 million and $0.2 million for the quarters ended July 3, 2010, and June 27, 2009, respectively. The Company currently has no outstanding debt. Total average cash and investments for the quarter ended July 3, 2010, was $39.5 million compared to $35.3 million for the quarter ended June 27, 2009. Although average cash increased, interest income remained flat due to lower interest rates compared to the prior year.

Foreign Currency Transaction Loss, Net

Foreign currency loss was $0.1 million and $0.3 million for the quarters ended July 3, 2010, and June 27, 2009, respectively. The current year loss is primarily related to the decrease in the Korean Won against the U.S. Dollar over the quarter. The prior year period loss was due to the revaluation of assets and liabilities held in U.S. Dollars at our U.K. subsidiary.

Miscellaneous (Income) Expense, Net

There was net miscellaneous income of $0.1 million for the quarter ended July 3, 2010, compared to a net miscellaneous expense of $0.1 million for the quarter ended June 27, 2009. The amounts are primarily made up of earnings and losses from joint ventures.

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Income Taxes

The provision for income taxes for the quarter ended July 3, 2010, was 34.4% of pretax income compared to 40.6% of pretax loss for the quarter ended June 27, 2009. The change was primarily due to the relative levels of income and different tax rates in effect among the countries in which the Company sells its products. The prior year provision includes a tax benefit recognized in the U.S. Additionally, the current period provision was affected by discrete items related to a reserve for uncertain tax positions from previous years. Excluding these discrete items, the effective rate would have been approximately 33%.

COMPARISON OF THE SIX MONTHS ENDED JULY 3, 2010 AND JUNE 27, 2009

Net Sales

Net sales were $70.9 million in 2010, a increase of $24.0 million, or 51.3%, compared to $46.8 million in 2009. Net sales increased 48.7% excluding the effect of exchange rates. The increase in net sales was primarily driven by increased demand in our end markets, which primarily include capital goods equipment. New product sales (defined as products introduced within the last five years) generally make up 10 - 15% of total sales.

North American sales increased 48.2% or $10.2 million, to $31.4 million, Asian sales increased 101.4% or $7.8 million, to $15.5 million, and European sales increased 28.3% or $4.7 million, to $21.3 million.

The U.S. reporting segment had sales of $44.2 million in 2010, up $16.0 million or 56.9%, compared to sales of $28.2 million last year. The increase was driven by demand in our end markets and the general upturn in the global economy. International sales out of the U.S. were $16.6 million in 2010, up 82.2% or $7.5 million, compared to $9.1 million last year. Significant increases in sales were noted in almost all geographic regions.

The Korean reporting segment had sales of $8.8 million in 2010, up $4.5 million or 103.4%, compared to sales of $4.3 million last year. Currency effect increased 2010 sales by approximately $1.2 million. The remaining increase is a result of efforts to expand and diversify its customer base, in addition to increased demand from existing customers.

The German reporting segment had sales of $9.4 million in 2010, up $1.8 million or 23.1%, compared to sales of $7.6 million last year. The increase was primarily related to demand within Germany. Currency effect decreased 2010 sales by approximately $0.1 million.

The U.K. reporting segment had sales of $8.4 million in 2010, up $1.7 million or 26.2%, compared to sales of $6.7 million last year. The increase was primarily related to demand within the U.K. There was minimal impact from currency during 2010.

Gross Profit

Gross profit increased $14.3 million or 145.6% to $24.1 million, compared to $9.8 million. Gross profit as a percentage of net sales increased to 34.0% in 2010, compared to 21.0% last year.

During the downturn of the prior year, the Company maintained its workforce and labor and variable overhead costs became essentially fixed. By maintaining its workforce, the Company has been able to respond to the increasing demand. As sales increase across all segments, the Company is experiencing productivity improvements and is able to leverage its overhead costs to generate higher gross profit.

Higher sales volume in 2010 contributed $5.1 million of the increase. The remaining increase in gross profit was attributed to productivity improvements of approximately $3.2 million, and decreases in overhead expenses as a percentage of sales of approximately $7.1 million, both of which occurred primarily in the U.S. The increase in gross profit was partially offset by higher material costs as a percent of sales of approximately $1.0 million.

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In June 2009, the Company initiated rolling furloughs for the production workforce and a 3% salary reduction for non-production personnel. Production employees were brought back throughout the first quarter of 2010 as demand increased. In April 2010, the Company ended its employee furlough program and restored the 3% salary decrease for all U.S. employees. There was no material impact from the furlough program during 2010.

Selling, Engineering and Administrative Expenses

Selling, engineering and administrative expenses increased 3.7%, or $0.4 million, to $10.0 million in 2010, compared to $9.6 million last year. The increase is primarily related to marketing efforts in Asia, and fringe benefit costs related to self-funded health plans in the U.S.

Operating Income

Operating income increased $13.9 million or 8,195.3% to $14.1 million in 2010, compared to $0.2 million last year, with operating margins of 19.9% and 0.4% for 2010 and 2009, respectively. Based on the Company s structure and decisions during the downturn, the increase in sales during 2010 has improved operating margins across all segments. During the downturn of the prior year, the Company maintained its workforce and labor and variable overhead costs became essentially fixed. By maintaining its workforce, the Company has been able to respond to the increasing demand. As sales increase across all segments, the Company is experiencing productivity improvements and is able to leverage its overhead costs to generate higher operating income.

The U.S. reporting segment contributed $9.9 million to our consolidated operating income during 2010, compared to an operating loss of $2.1 million during 2009, an increase of $12.0 million. The increase in the U.S. operating segments is primarily related to productivity gains and leverage of its overhead costs. Productivity gains contributed $3.0 million and decreases in variable and fixed overhead costs added $6.9 million to operating income. The remaining increases in operating income were primarily from absorption of selling, engineering, and administrative expenses which were relatively fixed.

The Korean reporting segment contributed $1.3 million to our consolidated operating income during 2010 compared to $0.2 million last year, an increase of $1.1 million. The increase in operating income was primarily related to material costs due to the strength of the Korean Won against the U.S. Dollar for material purchases made in U.S. Dollars, and productivity improvements totaling $0.6 million. The increase in sales volume resulted in $0.2 million of additional operating income.

The German reporting segment contributed $2.0 million to our consolidated operating income during 2010 compared to $1.3 million last year, an increase of $0.8 million. The increase was primarily due to the absorption of selling, engineering, and administrative expenses which were down $0.1 million in whole dollars. The increase in sales volume resulted in $0.3 million of additional operating income.

The U.K. reporting segment contributed $1.1 million to our consolidated operating income during 2010 compared to $0.6 million last year, a increase of $0.5 million. The increase was primarily related to productivity improvement of $0.2 million and decreased variable and fixed costs of $0.5 million. These amounts were partially offset by increased material costs of $0.4 million resulting from both product mix and a weakening British Pound against the U.S. Dollar for material purchased in U.S. Dollars.

Interest Income, Net

Net interest income was $0.3 million in 2010, and 2009. The Company currently has no outstanding debt. Total average cash and investments for the six months ended July 3, 2010, was $39.8 million compared to $34.5 million for the six months ended June 27, 2009. Although average cash increased, interest income remained flat due to lower interest rates compared to the prior year.

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Foreign Currency Transaction Loss, Net

There was minimal impact to net income from foreign currency during the six months ended July 3, 2010, compared to a foreign currency loss of $0.3 million during the six months ended June 27, 2009. The prior period loss was due to the strengthening of the British Pound against the U.S. Dollar and the revaluation of assets and liabilities held in U.S. Dollars at our U.K. subsidiary in the second quarter.

Miscellaneous (Income) Expense, Net

There was net miscellaneous income of $0.1 million in 2010, compared to a net miscellaneous expense of $0.3 for 2009. The amounts primarily represent earnings and losses from joint ventures.

Income Taxes

The provision for income taxes for the six months ended July 3, 2010, was 34.9% of pretax income compared to 108.4% of pretax loss for the six months ended June 27, 2009. The change was primarily due to the relative levels of income and different tax rates in effect among the countries in which the Company sells its products. The prior year provision includes a tax benefit recognized in the U.S. Additionally, the current period provision was affected by discrete items related to a reserve for uncertain tax positions from previous years. Excluding these discrete items, the effective rate would have been approximately 32.5%.

LIQUIDITY AND CAPITAL RESOURCES

Historically, the Company s primary source of capital has been cash generated from operations, although fluctuations in working capital requirements have from time to time been met through borrowings under revolving lines of credit. The Company s principal uses of cash have been to pay operating expenses, make capital expenditures, pay dividends to shareholders, repurchase Company common stock and service debt.

Cash from operations for the six months ended July 3, 2010, was $9.6 million, compared to $5.5 million for the six months ended June 27, 2009. The $4.1 million increase in the Company s net cash flow from operations during the period was due primarily to the increase in net income of $9.4 million and from increases in accruals and taxes receivable/payable totaling $4.7 million, compared to a decrease of $2.2 million during 2009. These amounts were partially offset by increases in accounts receivable and inventories of $8.1 million compared to a decrease of $3.6 million in the prior year. Cash on hand decreased $2.5 million from $30.4 million in 2009 to $28.0 million in 2010. However, this decrease was largely the result of net purchases of marketable securities totaling $5.7 million. Days sales outstanding (DSO) were 38 and 44 at July 3, 2010, and June 27, 2009, respectively. Inventory turns increased to 10.9 as of July 3, 2010, compared to 8.3 as of June 27, 2009.

Capital expenditures, consisting primarily of purchases of machinery and equipment, were $1.3 million for the six months ended July 3, 2010, compared to $3.5 million for the six months ended June 27, 2009. Capital expenditures for the year are projected to be approximately $6.0 million.

The Company declared a quarterly dividend of $0.09 per share to shareholders of record as of June 30, 2010, payable on July 15, 2010. 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.

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Off Balance Sheet Arrangements

The Company does not engage in any off balance sheet financing arrangements. In particular, the Company does not have any material interest in variable interest entities, which include special purpose entities and structured finance entities.

The Company uses the equity method of accounting to account for its investments in Sun China, WhiteOak and High Country Tek. The Company does not have a majority ownership in or exercise control over any of the entities. These investments were not material to the financial statements of the Company at July 3, 2010.

Seasonality

The Company generally has experienced increased sales during the second quarter of the year, largely as a result of the order patterns of our customers. As a result, the Company s second quarter net sales, income from operations and net income historically are the highest of any quarter during the year. However, due to the economic conditions of the past year, this pattern was not evident in 2009.

Inflation

The impact of inflation on the Company s operating results has been moderate in recent years. 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, 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

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.

Accounts Receivable

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

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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 5 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 January 2, 2010. 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 6 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, 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.

FORWARD-LOOKING INFORMATION

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

Important factors that could cause the actual results to differ materially from those in the forward-looking statements include, among other items, (i) the economic cyclicality of the capital goods industry in general and the hydraulic valve and manifold industry in particular, which directly affect customer orders, lead times and sales volume; (ii) conditions in the capital markets, including the interest rate environment and the availability of capital; (iii) changes in the competitive marketplace that could affect the Company s revenue and/or cost bases, such as increased competition, lack of qualified engineering, marketing, management or other personnel, and increased labor and raw materials costs; (iv) changes in technology or customer requirements, such as standardization of the cavity into which screw-in cartridge valves must fit, which could render the Company s products or technologies noncompetitive or obsolete; (v) new product introductions, product sales mix and the geographic mix of sales nationally and internationally; and (vi) changes relating to the Company s international sales, including changes in regulatory requirements or tariffs, trade or currency restrictions, fluctuations in exchange rates, and tax and collection issues. Further information relating to factors that could cause actual results to differ from those anticipated is included but not limited to information under the headings Item 1. Business, and Item 1A.

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Risk Factors in the Company s Form 10-K for the year ended January 2, 2010, and Management s Discussion and Analysis of Financial Conditions and Results of Operations in this Form 10-Q for the quarter ended July 3, 2010. 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 July 3, 2010.

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 July 3, 2010, the Company s management, under the direction of its Chief Executive Officer and the Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of the disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the time periods specified by the SEC s rules and forms, and is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, the Company s Chief Executive Officer and the Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective at the reasonable assurance level as of July 3, 2010, 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 July 3, 2010, that materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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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, 2010.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
None.

Item 3. Defaults Upon Senior Securities.
None.

Item 4. Reserved.

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.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Sarasota, State of Florida on August 10, 2010.

SUN HYDRAULICS CORPORATION

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

Financial and Accounting Officer)

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