



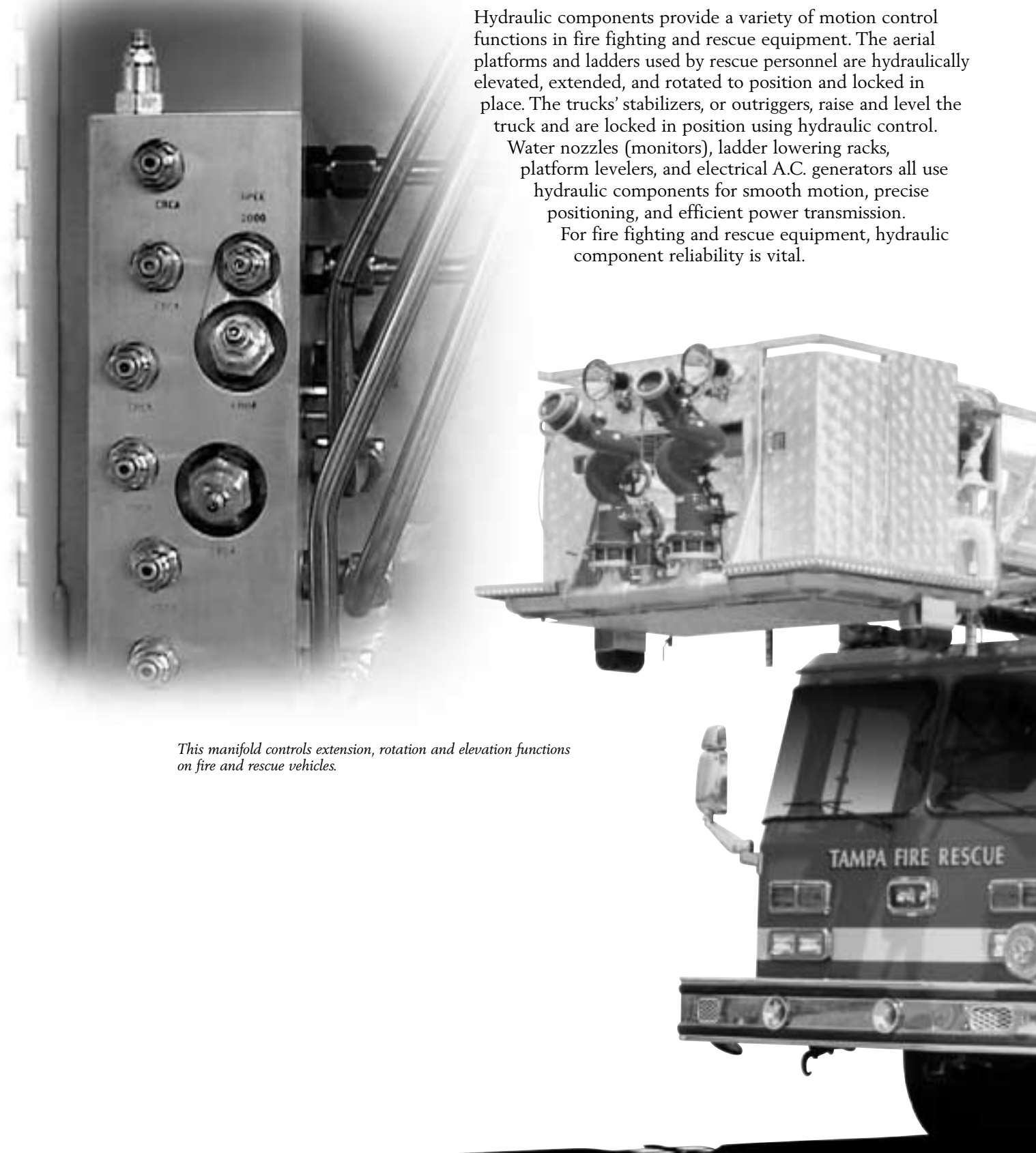
Sun Hydraulics Corporation 2000 Annual Report

About Sun Hydraulics

Hydraulic components provide a variety of motion control functions in fire fighting and rescue equipment. The aerial platforms and ladders used by rescue personnel are hydraulically elevated, extended, and rotated to position and locked in place. The trucks' stabilizers, or outriggers, raise and level the truck and are locked in position using hydraulic control.

Water nozzles (monitors), ladder lowering racks, platform levelers, and electrical A.C. generators all use hydraulic components for smooth motion, precise positioning, and efficient power transmission.

For fire fighting and rescue equipment, hydraulic component reliability is vital.



This manifold controls extension, rotation and elevation functions on fire and rescue vehicles.

Sun Hydraulics' flow control, relief, reducing, sequence, counterbalance, pilot check and solenoid cartridge valves, coupled with Sun's ability to package these valves in integrated circuit manifolds, provide precise and reliable control for all the functions previously mentioned. Our new solenoid and series "O" cartridge valves recently have been employed to safely limit rotation of the personnel carrier on a new aerial "bucket" truck. The small size of Sun's screw-in hydraulic cartridge valves allows manifold packages to be very compact, providing increased flexibility in their installation. Sun Hydraulics continues to develop and supply high performance hydraulic cartridge valves and manifolds that provide the dependability and reliability required in critical machine applications.

Some of Our End Product Uses

Mobile Products

- Agricultural Equipment • Waste Management Equipment • Cranes • Demolition Equipment • Vertical Drill Equipment • Forklifts and Attachments • Highway Construction Equipment • Off-Highway Construction Equipment • Fire Fighting and Rescue Equipment • Forestry Machinery • Mining Machinery • Oil Field Equipment • Marine Equipment • Sweeping Machinery • Trenching Machinery • Utility Equipment

Industrial Products

- Metal Cutting Machine Tools • Metal Forming Machine Tools • Robots and Factory Automation Equipment • Foundry Machinery • Molding Machinery • Paper Products Machinery • Food Processing Equipment • Textile Machinery • Packaging Equipment • Power Units and Test Stands



Photography supplied by Emergency One

Observations from Clyde Nixon, Allen Carlson and Bob Koski

Sun serves the capital goods markets and we are keenly aware that our business is cyclical. There are times of rapid growth, often in excess of 20% a year, followed by decline. Our objective is to sustain growth throughout the business cycle. We recognize there will be times when annual or semi-annual growth may be flat, or for a brief period negative, but that demand will return as the next cycle begins.

It is important to be in a position to be able to respond rapidly to demand, which often increases sharply as the business cycle turns up. To do this, the investment in processes, capacity, and people cannot fluctuate even though shipments have slowed. After three years of rapid growth in the mid-90's, Sun's shipments had increased more than 95% and we encountered capacity problems. Over the past four years, Sun has invested more than \$25 million in capital equipment to avoid this problem in the future.

In recent months the papers have been full of corporate layoffs and "restructuring", as public companies respond to short-term earnings pressures resulting from the slowdown in the economy. If the persons laid-off had learned to contribute significantly, you have to wonder how prepared such companies will be when their business improves. The loss will be felt.

For the past three years, Sun has invested significant capital and energy to improve our processes, strengthen our workforce and increase our capacity to better serve our customers and provide improved returns to our shareholders. The benefits of these investments and initiatives are evident in our 2000 financial results.

Demand for hydraulic products boomed in the first six months of 2000, before falling off significantly in the second half of the year. We are proud that we were able to maintain growth throughout the year, finishing the year with shipments 13.6% higher than the prior year. Sun's export business continued to grow with 40% of sales outside of the United States, remarkable for a company of Sun's size.

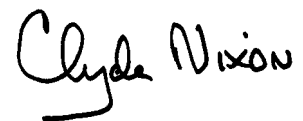
Despite the slow second half, our gross profit as a percent of sales held up well, thanks to the efforts of Sun's production personnel. Even with lower shipping volumes in the second half of the year, we were able to maintain our manufacturing profit margins and at the same time improve our customer service. For the year, gross profit as a percent of sales improved to 26.8%, compared to 23.3% in 1999. We expect gross profit to continue to improve with increasing shipment volume.

Since 1975, Sun has not had a workforce reduction. Even in the recessions of the early 80's and 90's, we were able to maintain our workforce in difficult times. Hours were fewer, shop and office pay was reduced, but when the business cycle improved, Sun was able to grow.

The best way to avoid overstaffing is to keep a healthy balance between direct labor employees (*value adders*) and overhead employees (*cost adders*). Sun maintains this balance through good years and bad. We give our direct labor workers the freedom to make decisions and be proactive. As a result, we are more productive than companies with large bureaucracies.

Maintaining a lean workforce has numerous advantages beyond a lower cost structure. Excess levels of overhead not only inflate costs, but also stifle initiative. A lean organization tends to be more efficient and agile and more adaptive to change. Our challenge is to anticipate and develop the resources our workforce needs to satisfy our customers.

We're where we want to be – bring on the recovery.

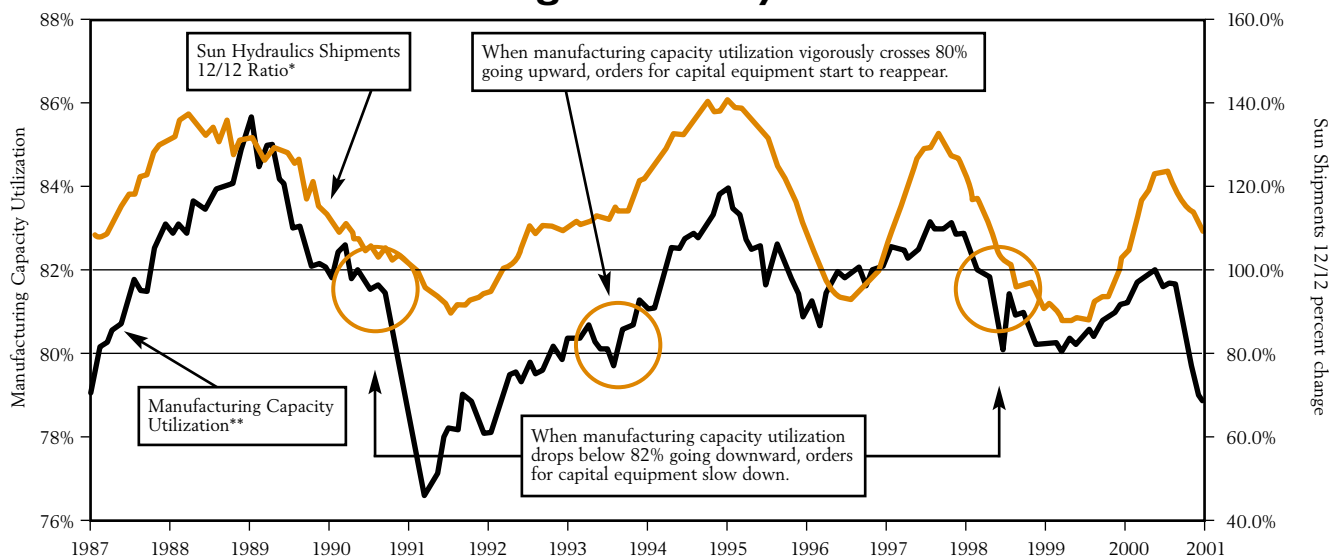


The indices we use to track manufacturing activity in the United States indicate continued weakness. However, orders in the first two months of 2001 were strong and we project first quarter shipments will be about 9% higher than the fourth quarter of 2000. Sun is prepared to react to further increases in demand. Even with temporary uncertainties in capital goods markets, we will continue to invest and add capacity to meet future growth.

Manufacturing capacity and quality, new product development, and communicating and maintaining strong routes to market remain our focus. We will continue to strengthen our personnel around the world and strive to reduce the time it takes to get new products to market. All of these efforts will contribute to further strengthening the Sun brand and providing value to our shareholders.



Manufacturing Capacity Utilization and Sun Hydraulics Corporation Shipments Through January 2001



*Sun shipments are U.S. shipments only (not consolidated) and are shown as a 12/12 ratio. This compares the shipments for the current 12 month period to the 12 month period ended one year earlier, and is stated as a percent change.

**Capacity utilization is shown as the actual percentage reported each month by the Federal Reserve Board.

Note: This data series was revised in December 2000 affecting data back to 1992.

Previously I described how, in an earlier life, I found enriching and enjoyable employment in a small company (less than 50 employees) whose culture deteriorated as the company grew to over 250 employees. Increasingly structured management had played a major role in frustrating employees. Starting Sun Hydraulics from scratch, I wanted to avoid such confrontations. How?

I had noted that outside ideas and people tended to be rejected (not invented here), but that as companies grew, they found it necessary to displace senior employees with new hires. Displaced people often felt cheated. After all, "hadn't they built the company?" Disgruntled employees generally left, taking valuable knowledge of products, processes and relationships with them. If they stayed, they often became powerful "passive obstructionists" within the organization.

New people were hired based on "job descriptions" and "job qualifications." Management typically seemed not to care about what was lost. Mistakes were often repeated. Morale suffered.

If Sun could avoid real and perceived demotions by adding peers instead of superiors and subordinates, would existing employees make room for new talent and remain productive and happy? Yes!

How about the factory floor? Sun adopted priorities for adding new processes and machinery: (1) improve safety, (2) reduce worker hassle, (3) improve quality, and (4) reduce costs. This is the reverse of most Japanese models. Employees formed teams to identify projects and suggest solutions.

"Outsiders" (new employees) were welcome if they had valuable knowledge. Promising projects were pursued without "cost justification." Ideas were tested. There were many failures, but some ideas worked spectacularly well. Very, very innovative machines were developed. In every case, we succeeded in satisfying all four priorities. Worker acceptance of new methods and equipment was automatic. Sun is now benchmarked for automation, worldwide.

By comparison, in conventional companies it is a cardinal sin **not** to have cost justifications and budgets for new equipment and projects. It is also a cardinal sin **not** to spend every penny in a budget. I am reminded of my father saying, "There is nothing quite so powerful as a bad idea whose time has come." Without formalities, good ideas at Sun proliferate. Bad ideas die.

One group of visitors from Germany insisted that we "must have a guiding genius behind all this automation." We gave them maps of the plant's departments and suggested that they interview employees for an hour, unaccompanied, and see if they could find this genius... we wanted to meet this person too!

An hour later they returned wide-eyed, saying that employees could easily identify team members who, during one part of a project or another, played a key role. No superstar could be found. They were amazed by the high levels of knowledge and enthusiasm they found everywhere.

More to follow...

Bois Kosicki

Selected Consolidated Financial Data

(in thousands except per share data)

YEARS ENDED	Dec. 30	Jan. 1	December 31,		
	2000	2000	1998	1997	1996 ⁽¹⁾
Statement of Income Data:					
Net sales	\$79,967	\$70,449	\$72,720	\$64,947	\$55,209
Gross profit	21,465	16,416	19,234	19,479	17,304
Operating income	7,356	4,038	7,688	8,302	5,290
Income before income taxes	5,919	2,664	8,520	7,264	4,200
Net income	<u>\$ 3,921</u>	<u>\$ 1,831</u>	<u>\$ 5,647</u>	<u>\$ 4,710</u>	<u>\$ 1,071</u>
Basic net income per common share	\$ 0.61	\$ 0.29	\$ 0.89	\$ 0.75	\$ 0.27
Diluted net income per common share	\$ 0.60	\$ 0.28	\$ 0.87	\$ 0.73	\$ 0.26
Other Financial Data:					
Depreciation and amortization	\$ 5,594	\$ 5,043	\$ 4,387	\$ 3,706	\$ 2,857
Capital expenditures	4,374	7,897	8,137	6,490	16,963
Balance Sheet Data:					
Cash and cash equivalents	\$ 2,698	\$ 1,122	\$ 1,592	\$ 1,249	\$ 1,038
Working capital	12,658	8,717	5,629	6,100	958
Total assets	64,374	64,074	61,019	53,389	48,416
Total debt	12,012	14,342	11,907	9,564	17,218
Shareholders' equity	43,836	41,176	40,015	35,000	22,397

(1) Pro forma net income is based on historical income as adjusted to reflect a provision for income taxes calculated using the statutory rates in effect during the applicable periods, as if the Company had been a C Corporation since inception. Unaudited pro forma net income was \$2,617 for the year ended December 31, 1996. Pro forma net income per share is based on estimated weighted average number of shares outstanding during the period, after giving effect to the reorganization and the initial public offering. Unaudited diluted pro forma net income per share was \$0.40 for the year ended December 31, 1996.

As of January 1, 1999, the Company changed from a calendar reporting year ending on December 31st to a fiscal year which will end on the Saturday closest to December 31st. Each quarter consists of two 4-week periods and one 5-week period.

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, primarily through independent distributors. Approximately 66% of product sales are used by the mobile market, 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. The remaining 34% of sales are used by industrial markets, which are characterized by equipment that is fixed in place, typically in a controlled environment, with higher pressures and duty cycles. The Company sells to both markets with a single product line. In 2000, the Company generated approximately 40% of its net sales outside of the United States, and its single largest end-user customer represented less than 3% of net sales.

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), United States orders for mobile hydraulic product increased 4.7% in 2000 compared to 1999, and orders of industrial hydraulic products increased 6.1% for the same time period.

Company orders for the year were \$76.5 million, an increase of \$7.0 million, or 10.1%, over 1999. Orders in the United States operation increased 5.0% in 2000, compared to 1999. Orders in the first half of 2000 in the United States increased 26.1% over 1999 and orders in the second half of 2000 decreased 13.1% compared to the same period in 1999. The order slowdown in the second half of 2000 was experienced throughout the United States fluid power industry. Orders in the European operations increased 16.1% in 2000 over 1999 with some slowdown occurring in the second half. The Korean operation's orders increased 54.5% in 2000 over 1999.

Net sales for the year were \$80.0 million, an increase of \$9.5 million, or 13.5%, over 1999. Gross profit as a percentage of net sales increased from 23.3% to 26.8%. Net income was \$3.9 million, or 4.9% of net sales. This compares with \$1.8 million, or 2.6% of sales, in 1999.

The Company's past investments in facilities, machinery, automated processes equipment and business systems produced favorable results in the year 2000. A significant decrease in production lead times greatly

improved the Company's response to its customer product delivery requirements. Productivity improvements reduced product costs. Capacity constraints, which have hampered operating results in the past, are no longer an issue.

The Company is currently focusing on marketing programs to stimulate demand by increasing the availability of product information to distributors and end users. The Company plans to expand the production space in the United Kingdom operation during the year 2001. This production capacity increase is in anticipation of future growth in Europe. The Company continues to explore new channels to market, including licensing, brand labeling, and other collaborative efforts within the industry.

Outlook

Prime manufacturing costs as a percent of sales in the first half of 2000 showed marked improvement over 1999. Customer order reductions in the second half of 2000 necessitated a lower level of production. Despite the lower volume, prime manufacturing, or variable costs as a percentage of sales, remained in line with the first half of 2000. Therefore, management believes that an increase in demand will result in gross profit levels, as a percent of sales, in excess of recent historical levels.

The order rate for the first two months of the first quarter of 2001 is running approximately 26.6% higher than the fourth quarter of 2000. Management projects that net sales in the first quarter of 2001 will be in the range of \$18.5 to \$19.5 million.

Results of Operations

The following table sets forth, for the periods indicated, certain items in the Company's statements of income as a percentage of net sales.

Years ended	Dec. 30 2000	Jan. 1 2000	Dec. 31 1998	Dec. 31 1997
Net sales	100.0%	100.0%	100.0%	100.0%
Gross profit	26.8	23.3	26.4	30.0
Operating income	9.2	5.7	10.6	12.8
Income before income taxes	<u>7.4%</u>	<u>3.8%</u>	<u>11.7%</u>	<u>11.3%</u>

Management's Discussion and Analysis of Financial Condition and Results of Operations

(Continued)

Comparison of Years Ended December 30, 2000 and January 1, 2000

Net sales for the year were \$80.0 million, an increase of \$9.5 million, or 13.5%, over 1999. This increase was due to strong orders in the first half of the year across all business segments. North American net sales increased 9.8% over 1999. European operations increased 19.0% over 1999. Net sales to Asian distributors increased 27.3% and Korean net sales increased 31.8% over 1999.

Gross profit increased to \$21.5 million in 2000, compared to \$16.4 million in 1999. Gross profit as a percentage of net sales increased to 26.8% in 2000, compared to 23.3% in 1999. The increase in gross profit as a percent of sales was primarily due to prime manufacturing cost reductions in the United States operation resulting from lower material costs and increased productivity.

Selling, engineering and administrative expenses increased \$1.7 million, or 14.0%, to \$14.1 million in 2000, compared to \$12.4 million in 1999. \$0.4 million of the increase was for product catalogues and \$0.3 million of the increase was related to systems and network development costs. The balance of the increase was primarily due to wage and fringe benefit increases.

Interest expense was \$1.1 million and \$1.0 million in 2000 and 1999, respectively. The interest expense related to the unsecured line of credit, long-term mortgages and related party debt decreased \$0.2 million, while interest on the secured line of credit in the United States, which was converted to a four year note on July 23, 2000 (See Note 9 to the Financial Statements), increased \$0.3 million.

Miscellaneous (income) expense was \$0.3 million in 2000, compared to \$0.4 million in 1999. The \$0.1 million decrease was due to a decrease in equity losses on the joint venture in China and a decrease in foreign currency exchange losses.

The income tax provision for the year ended December 30, 2000, was 33.8% of pretax income, compared to 31.3% for the year ended January 1, 2000. This increase is due to Korean tax provision requirements that were not previously believed to be applicable. In both years, tax savings were realized in the United States from the Sun Hydraulics Foreign Sales Corporation.

Comparison of Years Ended January 1, 2000 and December 31, 1998

Net sales decreased 3.1%, or \$2.3 million, to \$70.4 million in fiscal 1999, compared to \$72.7 million in 1998. Excluding the Korean operation, acquired in September 1998, net sales decreased approximately 6.2%, or \$4.4 million. This decrease was due primarily to a slowdown in the capital goods industry, and thus, the fluid power industry. Many agricultural, mining, paper and machine tool equipment makers saw significant volume declines in 1999. Domestic net sales decreased \$4.9 million, European net sales decreased \$0.6 million, and Asian net sales, excluding Korea, were flat for the year, with a large increase in the fourth quarter of 1999 over the fourth quarter of 1998.

Gross profit decreased to \$16.4 in fiscal 1999, compared to \$19.2 million in 1998. Gross profit as a percentage of net sales decreased to 23.3% in 1999, from 26.4% in 1998. The decrease in gross profit as a percent of sales was due primarily to lower net sales spread over a higher fixed cost base. Also, productivity in the United States and United Kingdom operations was adversely affected by the implementation of new, fully integrated manufacturing systems. The resultant increases in direct labor and related expenses were partially offset by reduced material costs related to the Company's supplier initiative program.

Selling, engineering and administrative expenses increased \$0.9 million, or 7.8%, to \$12.4 million in 1999, compared to \$11.5 million in 1998. Approximately \$0.3 million of the increase was due to the Korean operation acquired in September 1998. The balance of the increase represents higher wages, increased advertising, and one time system implementation costs offset by lower pension costs.

Interest expense was \$1.0 million and \$0.8 million in 1999 and 1998, respectively. The interest expense related to long-term mortgages and related party debt decreased while interest on the unsecured and secured lines of credit in the United States increased \$0.2 million. The new secured line of credit was used to facilitate cash flow related to specific capital acquisitions over a four-year term.

Miscellaneous (income) expense was \$0.4 million in 1999 compared to (\$1.7) million in 1998. In 1998, the Company received a \$1.7 million payment in settlement of a business-interruption insurance claim. This claim was related to a fire in September 1996, at the Manatee County facility while it was under construction, and delayed the opening of

operations. Other expenses increased primarily as the result of the disposal of certain equipment in the United States operation no longer used in production, equity losses on the joint venture in China, and foreign currency exchange transactions.

The income tax provision for the year ended January 1, 2000, was 31.3% of pretax income

compared to 33.7% for the year ended December 31, 1998. Excluding income from the Korean operation, the provision for income taxes in the twelve months ended January 1, 2000, was 32.5%, compared to 33.2% in 1998. Tax savings were realized in the United States from the Sun Hydraulics Foreign Sales Corporation and in Korea from provisions of local law.

Quarterly Results of Operations

(in thousands)

Quarter Ended	Dec. 30 2000	Sept. 30 2000	July 1 2000	April 1 2000	Jan. 1 2000	Sept. 30 1999	June 30 1999	March 31 1999
Net sales	\$17,537	\$20,137	\$22,060	\$20,233	\$17,801	\$17,863	\$16,120	\$18,665
Gross profit	4,721	5,486	6,176	5,082	4,562	4,458	2,907	4,489
Operating income	1,377	1,887	2,653	1,439	1,404	1,333	(129)	1,430
Income before income taxes	1,021	1,550	2,148	1,200	1,035	891	(341)	1,079
Net income	<u>\$ 667</u>	<u>\$ 1,021</u>	<u>\$ 1,376</u>	<u>\$ 857</u>	<u>\$ 735</u>	<u>\$ 588</u>	<u>\$ (216)</u>	<u>\$ 724</u>

Liquidity and Capital Resources

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

Cash flow from operations in 2000 was \$9.5 million, compared to \$5.6 million in 1999 and \$8.6 million in 1998. The increase in the Company's cash flow from operations in 2000 compared to 1999 was due primarily to an increase in net income of \$2.1 million and an increase in depreciation and amortization of \$0.6 million. The decrease in the Company's cash flow from operations in 1999 compared to 1998 was due primarily to a decrease in net income of \$3.8 million, offset by an increase in depreciation and amortization of \$0.7 million.

Capital expenditures were \$4.4 million in 2000, compared to \$7.9 million in 1999 and \$8.1 million in 1998. Capital expenditures in the year 2001 will include approximately \$2.2 million to cover the cost of an expansion of the United Kingdom operation.

On July 23, 2000, the Company replaced its \$5.0 million unsecured, revolving credit facility with a two year, unsecured, revolving credit facility of \$7.5 million and converted the outstanding balance of \$5.7 million on its \$7.5 million secured, revolving credit facility to a four year, secured, term loan. The \$7.5 million

credit facility has an interest rate equal to the bank lender's prime rate less 1% or LIBOR plus 1.9% for predetermined periods of time, at the Company's option. The term loan has an interest rate equal to the bank lender's prime rate less 1%. At December 30, 2000, the interest rate for both facilities was 7.99%. At December 30, 2000, the balances outstanding on the unsecured and secured facilities were \$0 and \$5.2 million, respectively. Both credit facilities are subject to certain debt covenants.

A 10-year mortgage loan of \$6.2 million was obtained, at a fixed interest rate of 8.25%, for construction of the Manatee County facility. Terms on the construction note were interest-only on the balance drawn down through the completion of construction and then conversion to a 10-year mortgage note with a 15-year amortization schedule. In April 1999, this mortgage note was renegotiated to an interest rate of 7.375%. Terms are monthly principal and interest payments with remaining principal due July 1, 2006. At December 30, 2000, \$4.6 million was outstanding under this mortgage loan.

In Germany, the Company has a \$0.9 million line of credit, denominated in Euros, which bears interest at a variable rate equal to 1.5% over the Euribor and expires on October 31, 2002. At December 30, 2000, there was no balance outstanding on this credit facility.

In February 1999, the Company negotiated three loans in Germany secured by equipment, a ten year 5.1% fixed interest rate loan for approximately \$0.3 million, a ten year 5.1% fixed interest rate loan for approximately \$0.1 million, and a ten year 3.5% fixed interest rate loan

Management's Discussion and Analysis of Financial Condition and Results of Operations

(Continued)

for approximately \$0.8 million. At December 30, 2000, the outstanding balances on these facilities were \$0.2 million, \$0, and \$0.6 million, respectively.

In May 1996, the Company obtained a mortgage loan of approximately \$2.4 million, denominated in German marks, for the new facility in Erkelenz, Germany. This loan had a term of 12 years with variable interest of 6.47%. During 1999, the Company renegotiated this loan with a mortgage note, bearing fixed interest at 6.05%, with monthly payments and a maturity date of September 30, 2008. At December 30, 2000, \$1.1 million was outstanding under this mortgage note.

On September 8, 2000, the Company obtained a loan in Korea for approximately \$0.1 million, secured by equipment. The loan has a fixed interest rate of 10.2%. Monthly payments of interest and principle began in November 2000, with the final payment due in September 2001. At December 30, 2000, the outstanding balance was \$0.1 million.

In April 2000, the Company obtained a loan in Korea for approximately \$0.1 million, secured by equipment. The loan has a variable interest rate of between 3% and 5%; the current rate on the loan is 4%. Terms are monthly interest payments only through April 2003, and monthly principal and interest payments from May 2003, through April 2006.

Sun Korea has a secured note denominated in Korean Won, with interest payable at a fixed rate of 6%, with a maturity date of June 25, 2001. At December 30, 2000, \$0 was outstanding under this credit facility.

In England, the Company has a \$1.2 million line of credit, denominated in British pounds, which bears interest at a floating rate equal to 2.25% over the bank's base rate and is payable on demand. At December 30, 2000, there was no balance outstanding on this credit facility.

The Company believes that cash generated from operations and its borrowing availability under its revolving lines of credit will be sufficient to satisfy the Company's operating expenses and capital expenditures for the foreseeable future.

The Company declared quarterly dividends of \$0.04 per share to shareholders of record on the last day of each calendar quarter in 2000 and 1999. These dividends were paid on the 15th day of each month following the date of declaration.

The Company's Board of Directors currently intends to continue to pay a quarterly dividend of at least \$0.04 per share during 2001. However, 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.

Seasonality

The Company generally has experienced reduced activity during the fourth quarter of the year, largely as a result of fewer working days due to holiday shutdowns. As a result, the Company's fourth quarter net sales, income from operations, and net income typically are the lowest of any quarter during the year. However, during fiscal 1999, due to the Company's poor second quarter results, this was not the case.

Inflation

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

Euro

In January 2000, the German Operation adopted the Euro as its primary currency. The Company presently believes that, with remediation measures, any material risks associated with the Euro Conversion can be mitigated.

QUANTITATIVE AND QUALITATIVE DISCLOSURE 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. At December 30, 2000, the Company had approximately \$5.4 million in variable-rate debt outstanding and, as such, the market risk is immaterial based upon a 10% increase or decrease in interest rates. The Company manages this risk by selecting unsecured debt financing at its lenders' prime rate less 1%, or the LIBOR rate plus 1.9%, whichever is the more advantageous.

FORWARD-LOOKING INFORMATION

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

Important factors that could cause the actual results to differ materially from those in the forward-looking statements include, among other items, (i) the economic cyclicality of the capital goods industry in general and the hydraulic valve and manifold industry in particular, which directly affect customer orders, lead times and sales volume; (ii) conditions in the capital markets, including the interest rate environment and the availability of capital; (iii) changes in the competitive marketplace that could affect the Company’s revenue and/or cost bases, such as increased competition, lack of qualified engineering, marketing, management or other personnel, and increased labor and raw materials costs; (iv) changes in technology or customer requirements, such as standardization of the cavity into which screw-in cartridge valves must fit, which could render the Company’s products or technologies noncompetitive or obsolete; (v) new product introductions, product sales mix and the geographic mix of sales nationally and internationally; and (vi) changes relating to the Company’s international sales, including changes in regulatory

requirements or tariffs, trade or currency restrictions, fluctuations in exchange rates, and tax and collection issues. Further information relating to factors that could cause actual results to differ from those anticipated is included but not limited to information under the headings “Business,” particularly under the subheading, “Business Risk Factors” and “Management’s Discussion and Analysis of Financial Conditions and Results of Operations” in the Company’s Form 10-K for the year ended December 30, 2000. 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.

Report of Independent Certified Public Accountants

To the Board of Directors and Shareholders
of Sun Hydraulics Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, changes in shareholders' equity and comprehensive income, and of cash flows present fairly, in all material respects, the financial position of Sun Hydraulics Corporation and its subsidiaries at December 30, 2000, January 1, 2000, and December 31, 1998, and the results of their operations and their cash flows for the three years then ended, in conformity with accounting principles which, as described in Note 2, are generally accepted in the United States of America. 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 of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

PricewaterhouseCoopers LLP

March 2, 2001

Consolidated Balance Sheets

(in thousands)

FOR THE YEAR ENDED	Dec. 30, 2000	Jan. 1, 2000
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 2,698	\$ 1,122
Accounts receivable, net of allowance for doubtful accounts of \$163 and \$196	6,112	6,260
Inventories	9,033	8,131
Taxes receivable	–	455
Other current assets	536	591
TOTAL CURRENT ASSETS	18,379	16,559
Property, Plant and Equipment, Net	44,984	46,529
Other Assets	1,011	986
TOTAL ASSETS	\$64,374	\$64,074
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 1,787	\$ 2,712
Accrued expenses and other liabilities	1,585	1,464
Long-term debt due within one year	1,779	3,411
Dividends payable	255	255
Income taxes payable	315	–
TOTAL CURRENT LIABILITIES	5,721	7,842
Long-Term Debt Due After One Year	10,233	10,931
Deferred Income Taxes	4,106	4,125
Deferred Royalties	478	–
TOTAL LIABILITIES	20,538	22,898
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, 6,384,948 shares outstanding	6	6
Capital in excess of par value	24,486	24,486
Retained earnings	19,073	16,173
Accumulated other comprehensive income	271	511
TOTAL SHAREHOLDERS' EQUITY	43,836	41,176
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$64,374	\$64,074

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

Consolidated Statements of Income

(in thousands except per share data)

FOR THE YEAR ENDED	Dec. 30, 2000	Jan. 1, 2000	Dec. 31, 1998
Net sales	\$79,967	\$70,449	\$72,720
Cost of sales	58,502	54,033	53,486
Gross profit	21,465	16,416	19,234
Selling, engineering and administrative expenses	14,109	12,378	11,546
Operating income	7,356	4,038	7,688
Interest expense	1,114	954	837
Other miscellaneous (income) expense	323	420	(1,669)
Income before income taxes	5,919	2,664	8,520
Income tax provision	1,998	833	2,873
Net income	\$ 3,921	\$ 1,831	\$ 5,647
Basic net income per common share	\$ 0.61	\$ 0.29	\$ 0.89
Weighted average shares outstanding	6,385	6,380	6,345
Diluted net income per common share	\$ 0.60	\$ 0.28	\$ 0.87
Weighted average diluted shares outstanding	6,574	6,569	6,531

Consolidated Statement of Changes in Shareholders' Equity and Comprehensive Income

(in thousands)

	Shares	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance, December 31, 1997	6,322	\$ 6	\$24,163	\$10,732	\$ 99	\$35,000
Dividends declared				(1,016)		(1,016)
Exercise of stock options	39		223			223
Comprehensive income:						
Net income				5,647		5,647
Foreign currency translation adjustments					161	161
Comprehensive income						5,808
Balance, December 31, 1998	6,361	6	24,386	15,363	260	40,015
Dividends declared				(1,021)		(1,021)
Exercise of stock options	22		75			75
Issue of stock	2		13			13
Tax effect of non-qualified stock options			12			12
Comprehensive income:						
Net income				1,831		1,831
Foreign currency translation adjustments					251	251
Comprehensive income						2,082
Balance, January 1, 2000	6,385	6	24,486	16,173	511	41,176
Dividends declared				(1,021)		(1,021)
Comprehensive income:						
Net income				3,921		3,921
Foreign currency translation adjustments					(240)	(240)
Comprehensive income						3,681
Balance, December 30, 2000	6,385	\$ 6	\$24,486	\$19,073	\$ 271	\$43,836

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

Consolidated Statements of Cash Flows

(in thousands)

FOR THE YEAR ENDED	Dec. 30, 2000	Jan. 1, 2000	Dec. 31, 1998
Cash Flows From Operating Activities:			
Net income	\$ 3,921	\$ 1,831	\$ 5,647
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	5,594	5,043	4,387
Loss on disposal of assets	273	281	-
Compensation expense of stock options	-	13	-
Provision for deferred income taxes	(19)	481	453
(Increase) decrease in:			
Accounts receivable	181	(945)	(665)
Allowance for doubtful accounts	(33)	27	122
Inventories	(902)	(6)	(877)
Income tax receivable, net	455	(700)	-
Other current assets	55	300	38
Other assets	19	30	86
Increase (decrease) in:			
Accounts payable	(925)	(165)	(167)
Accrued expenses and other liabilities	121	(601)	(279)
Income taxes payable, net	315	-	(135)
Deferred royalties	478	-	-
Net cash provided by operating activities	<u>9,533</u>	<u>5,589</u>	<u>8,610</u>
Cash Flows From Investing Activities:			
Investment in acquisition and joint venture	(100)	-	(1,110)
Capital expenditures	(4,374)	(7,897)	(8,137)
Proceeds from dispositions of equipment	108	96	143
Net cash used in investing activities	<u>(4,366)</u>	<u>(7,801)</u>	<u>(9,104)</u>
Cash Flows From Financing Activities:			
Proceeds from debt	2,999	13,206	9,323
Repayment of debt	(4,951)	(10,106)	(7,039)
Repayment of notes payable to related parties	(378)	(663)	(765)
Proceeds from exercise of stock options	-	75	223
Dividends to shareholders	(1,021)	(1,021)	(983)
Net cash provided by (used in) financing activities	<u>(3,351)</u>	<u>1,491</u>	<u>759</u>
Adjustment for Other Comprehensive Income	<u>(240)</u>	<u>251</u>	<u>78</u>
Net Increase (Decrease) in Cash and Cash Equivalents	1,576	(470)	343
Cash and Cash Equivalents, Beginning of Period	1,122	1,592	1,249
Cash and Cash Equivalents, End of Period	<u>\$ 2,698</u>	<u>\$ 1,122</u>	<u>\$ 1,592</u>
Supplemental Disclosure of Cash Flow Information:			
Cash paid for:			
Interest	<u>\$ 1,114</u>	<u>\$ 1,002</u>	<u>\$ 954</u>
Income taxes	<u>\$ 1,247</u>	<u>\$ 1,052</u>	<u>\$ 2,555</u>

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

Notes to Consolidated Financial Statements

1. Business

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

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.

Reclassification

Certain amounts shown in the 1998 and 1999 consolidated financial statements have been reclassified to conform with the 2000 presentation. These reclassifications did not have any effect on total assets, total liabilities, stockholders’ equity or net income.

Management Estimates and Assumptions

The preparation of financial statements in conformity with generally accepted accounting principles 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 Week Fiscal Year

Commencing in 1999, the Company implemented a fiscal year which ends on the Saturday nearest to the end of the month of December. Each quarter consists of two 4-week periods and one 5-week period.

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.

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

Capitalized Software Costs

Capitalized software costs are accounted for under “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use” (“SOP 98-1”) and are recorded at cost less accumulated depreciation. Software is capitalized upon the successful testing of the system. Depreciation is charged to income over the estimated useful life of the software. The amounts capitalized during 2000 and 1999 were \$152 and \$528, respectively.

Valuation Assessment of Long-Lived Assets

Management periodically evaluates long-lived assets for potential impairment and will reserve for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be fully recoverable. As of December 30, 2000, management does not believe that any assets are impaired.

Other Assets

Other assets consists of goodwill and an equity investment. Goodwill, which represents the excess of the purchase price of acquisitions over the fair value of the net assets acquired and other acquisition costs are carried at cost, net of accumulated amortization and amortized on a straight-line basis over fifteen years. The equity investment represents the Company's joint venture in China. The equity investment was recorded at cost and adjusted for investment income or loss and dividend distributions for each period.

Revenue Recognition

Sales are recognized when products are shipped. 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.

Research and Development Expense

Included in selling, engineering and administrative expenses are amounts incurred for research and development costs paid to third parties for the Company's manufacturing processes and related software which approximated \$61, \$50, and \$466 for the years ended December 30, 2000, January 1, 2000, and December 31, 1998, respectively.

Advertising Costs

The Company expenses the costs for advertising and promotional literature during the year incurred. Included in selling, engineering and administrative expenses are amounts incurred for advertising and promotional literature which approximated \$1,095, \$728, and \$262 for the years ended December 30, 2000, January 1, 2000, and December 31, 1998, respectively.

Foreign Currency Translation and Transactions

The Company follows the translation policy provided by Statement of Financial Accounting Standards No. 52, "Foreign Currency Translation." The Pound Sterling is the functional currency of Sun Ltd. The Euro is the functional currency of 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 monetary 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 in the component of shareholders' equity designated as "accumulated other comprehensive income." Realized gains and losses from foreign currency translations are included in miscellaneous (income) expense.

Income Taxes

The Company follows the income tax policy provided by Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes." 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 and stock options.

Stock-Based Compensation

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

3. Fair Value of Investments

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, accounts receivable, other current assets, accounts payable, accrued expenses and other liabilities approximate fair value due to the nature of their short maturities.

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.

Notes to Consolidated Financial Statements

(Continued)

4. Inventories

	Dec. 30, 2000	Jan. 1, 2000
Raw materials	\$ 3,300	\$ 2,602
Work in process	3,145	3,452
Finished goods	2,588	2,077
	<u>\$ 9,033</u>	<u>\$ 8,131</u>

5. Property, Plant and Equipment

	Dec. 30, 2000	Jan. 1, 2000
Machinery and equipment	\$41,443	\$37,065
Office furniture and equipment	8,755	8,124
Buildings	19,618	18,518
Leasehold and land improvements	1,038	881
Construction in progress	1,125	3,518
Land	2,481	2,481
	<u>74,460</u>	<u>70,587</u>
Less: Accumulated depreciation	<u>(29,476)</u>	<u>(24,058)</u>
	<u>\$44,984</u>	<u>\$46,529</u>

Depreciation expense for the years ended December 30, 2000, January 1, 2000, and December 31, 1998 totaled \$5,538, \$4,993, and \$4,387, respectively.

6. Other Assets

	Dec. 30, 2000	Jan. 1, 2000
Goodwill and other acquisition costs – Sun Korea	\$ 758	\$ 817
Equity investment in joint venture	194	146
Other	59	23
	<u>\$ 1,011</u>	<u>\$ 986</u>

7. Accrued Expenses and Other Liabilities

	Dec. 30, 2000	Jan. 1, 2000
Compensation and benefits	\$ 1,161	\$ 677
Deferred grant	–	424
Insurance	207	177
Other accrued expenses	217	186
	<u>\$ 1,585</u>	<u>\$ 1,464</u>

8. Long-Term Debt

	Dec. 30, 2000	Jan. 1, 2000
\$7,500 two year, unsecured, revolving credit line in U.S., interest at Bank lender's prime rate less 1% or LIBOR plus 1.9% (7.99% at December 30, 2000), due July 23, 2002	\$ –	\$ 2,215
\$5,677 four year, note, secured by U.S. equipment, interest at Bank lender's prime rate less 1% or LIBOR plus 1.9% (7.99% at December 30, 2000), due July 23, 2004	5,167	4,616
\$6,187 10-year mortgage note with 15-year amortization schedule on the U.S. Manatee County facility, fixed interest rate of 7.375%, due July 1, 2006	4,575	4,725
\$2,400 12-year mortgage note on the German facility, fixed interest rate of 6.05%, due September 30, 2008	1,118	1,352
10-year notes, fixed interest rates ranging from 3.5- 5.1%, secured by equipment in Germany and due in February, 2009	811	933
Notes, fixed and variable interest ranging from 3-10.2%, secured by equipment in Korea	240	22
Other	101	479
	<u>12,012</u>	<u>14,342</u>
Less amounts due within one year	<u>(1,779)</u>	<u>(3,411)</u>
	<u>\$10,233</u>	<u>\$10,931</u>

The remaining principal payments are due as follows: 2002 - \$2,098; 2003 - \$1,979; 2004 - \$1,418; 2005 - \$514; and 2006 thereafter - \$4,224.

(in thousands except per share data)

The Company has three revolving lines of credit agreements totaling \$9,576 with various banks. Interest rates on these credit facilities are variable based on the prime rate in the U.S. and the equivalent rate in the U.K. and Germany, respectively. All lines of credit expire in 2002. None of these arrangements contain pre-payment penalties. The total outstanding on these credit facilities at December 30, 2000 and January 1, 2000 was \$0 and \$2,215, respectively.

Capitalized interest was \$90 for the year ended December 31, 1998.

Certain of these debt instruments are subject to debt covenants including consolidated net working capital not less than \$2,000,000 and a current ratio not less than 1.2:1.0 at all times during the term of the loan.

Subsequent to December 30, 2000, Germany has obtained two loans: a government backed loan of \$381, secured by equipment, and a bank loan of \$191 for the remainder of the equipment not covered by the government loan. The loans are due on March 31, 2011 and December 31, 2010, respectively.

9. Distributions and Dividends to Shareholders

The Company declared distributions of \$ 1,021, \$1,021, and \$1,016 to shareholders in 2000, 1999, and 1998, respectively.

On March 3, 2001, the Company declared a cash dividend of \$0.04 per share to shareholders of record on March 31, 2001, payable on April 15, 2001. The Company declared quarterly dividends of \$0.04 per share to shareholders of record on the last day of each quarter in 2000 and 1999. These dividends were paid on the 15th day of each month following the date of declaration.

10. Income Taxes

Pretax income is taxed under the following jurisdictions:

FOR THE YEAR ENDED	Dec. 30, 2000	Jan. 1, 2000	Dec. 31, 1998
United States	\$3,807	\$1,439	\$6,854
Foreign	2,112	1,325	1,666
Total	<u>\$5,919</u>	<u>\$2,764</u>	<u>\$8,520</u>

The income tax provision consists of the following:

FOR THE YEAR ENDED	Dec. 30, 2000	Jan. 1, 2000	Dec. 31, 1998
Current tax expense:			
United States	\$1,300	\$ 38	\$1,662
State and local	110	1	159
Foreign	594	326	600
Total current	<u>2,004</u>	<u>365</u>	<u>2,421</u>
Deferred tax expense (benefit):			
United States	0	573	411
State and local	0	51	36
Foreign	(6)	(156)	5
Total deferred	<u>(6)</u>	<u>468</u>	<u>452</u>
Total income tax provision	<u>\$1,998</u>	<u>\$ 833</u>	<u>\$2,873</u>

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

FOR THE YEAR ENDED	Dec. 30, 2000	Jan. 1, 2000	Dec. 31, 1998
U.S. federal taxes at statutory rate	\$2,012	\$ 940	\$2,897
Increase (decrease)			
Benefit of foreign sales corporation	(30)	(59)	(60)
Foreign income taxed at higher rate	(129)	(104)	(59)
Nondeductible items	70	27	(42)
State and local taxes, net	75	29	137
Income tax provision	<u>\$1,998</u>	<u>\$ 833</u>	<u>\$2,873</u>

Deferred tax assets and liabilities at fiscal year end are as follows:

	Dec. 30, 2000	Jan. 1, 2000	Dec. 31, 1998
Deferred taxes, non-current:			
Assets			
Accrued expenses and reserves not currently deductible	\$ 161	\$ 109	\$ 132
Compensation expense recognized for book, not yet deductible for tax	329	329	388
Deferred royalty income	177	—	—
Deferred tax asset, non-current	667	438	520
Liabilities			
Depreciation	(4,773)	(4,563)	4,176
Net deferred tax liability, non-current	<u>\$(4,106)</u>	<u>\$4,125</u>	<u>\$3,656</u>

11. Stock Option Plans

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 1,000 shares of the Company's common stock by officers, employees and Directors of the Company. Under 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 each of the three years ended December 30, 2000, January 1, 2000, and December 31, 1998, is summarized as follows:

	(share amounts in thousands)		
	Number of Shares	Exercise Price Range	Weighted Average Exercise Price
Under option, December 31, 1997 (357 shares exercisable)	587	\$ 3.00- 9.50	\$ 6.69
Granted	220	\$10.00-16.75	\$15.22
Exercised	(39)	\$ 3.00- 9.50	\$ 5.75
Under option, December 31, 1998 (385 shares exercisable)	768	\$ 3.00-16.75	\$ 9.18
Exercised	(22)	\$ 3.00- 3.47	\$ 3.39
Forfeitures	(80)	\$ 9.50	\$ 9.50
Under option, January 1, 2000 (453 shares exercisable)	666	\$ 3.00-16.75	\$ 9.19
Granted	103	\$ 6.00- 8.00	\$ 7.36
Forfeitures	(13)	\$10.00-16.75	\$15.19
Under option, December 30, 2000 (526 shares exercisable)	756	\$ 3.00-16.75	\$ 7.84

A summary of outstanding and exercisable options at December 30, 2000 is summarized as follows:

OPTIONS OUTSTANDING

Range of exercise prices	Number of shares	Weighted-average remaining contractual life	Weighted-average exercise price
\$ 3.00	62,746	3.08	\$ 3.00
3.43-5.05	189,068	5.75	4.41
6.00	10,000	9.00	6.00
6.75	37,000	9.83	6.75
8.00	56,000	9.67	8.00
9.50	194,385	5.35	9.50
10.00	47,000	7.92	10.00
16.75	160,000	7.33	16.75

OPTIONS EXERCISABLE

Range of exercise prices	Number of shares	Weighted-average exercise price
\$ 3.00	62,746	\$ 3.00
3.43-5.05	189,068	4.41
6.00	60,000	6.00
6.75	-	6.75
8.00	-	8.00
9.50	150,592	9.50
10.00	47,000	10.00
16.75	67,000	16.75

The Company has adopted the disclosure-only provisions of SFAS No. 123. Accordingly, no compensation cost has been recognized for the stock option plans other than for nonqualified stock options. Had compensation costs for the stock option plans been determined based on the fair value at the grant date for awards in 2000 and 1998 (there were no options granted in 1999) consistent with the provisions of SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

FOR THE YEAR ENDED	Dec. 30, 2000	Jan. 1, 2000	Dec. 31, 1998
Net income:			
As reported	\$3,921	\$1,831	\$5,647
Pro forma	3,418	1,404	5,188
Basic earnings per common share:			
As reported	0.61	0.29	0.89
Pro forma	0.54	0.22	0.82
Diluted earnings per common share:			
As reported	0.60	0.28	0.87
Pro forma	0.52	0.21	0.79

(in thousands except per share data)

These pro forma amounts may not be representative of future disclosures since the estimated fair value of stock options is amortized to expense over the vesting period and additional options may be granted in future years. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2000 and 1998: cumulative volatility of 40.0%, and 43.09% for 2000 and 1998, respectively; dividend yields of 2.41%, and 1.68%, for 2000 and 1998, respectively; risk-free interest rate of 5.11%, and 5.72%, for 2000 and 1998, respectively; and expected terms of 3.00 to 6.00 years for 2000 and 6.59 years for 1998.

12. 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 \$1,195, \$702, and \$982 during 2000, 1999, and 1998, 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 \$110, \$124, and \$93 during 2000, 1999, and 1998, respectively.

13. Segment Reporting

In 1998, the Company adopted Statement of Accounting Standards No. 131, "Disclosures about Segments of Enterprise and Related Information" ("SFAS 131"). SFAS 131 supercedes SFAS 14, "Financial Reporting for Segments of a Business Enterprise," replacing the "industry segment" approach with the "management" approach of determining reportable segments of an organization. The management approach designates the internal organization that is used by management for making operational decisions and addressing performance as the source of determining the Company's reportable segments. Management bases its financial decisions by the geographical location of its operations.

The individual subsidiaries comprising the Company operate predominantly in a single industry as manufacturers and distributors of hydraulic components. The subsidiaries are multinational with operations in the United States, the United Kingdom, Germany, and Korea. In computing earnings from operations for the foreign subsidiaries, no allocations of general corporate expenses, interest or income taxes have been made.

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:

SEGMENT INFORMATION

	United States	Korea	United Kingdom	Germany	Elimination	Consolidated
2000						
Sales to unaffiliated customers	\$55,488	\$5,537	\$13,026	\$5,916	\$ -	\$79,967
Intercompany sales	11,232	-	1,814	29	(13,075)	-
Operating profits	5,021	307	1,834	281	(87)	7,356
Identifiable assets	48,717	1,966	10,285	4,757	(1,351)	64,374
Depreciation and amortization	4,283	166	874	271	-	5,594
Capital expenditures	3,213	450	762	(51)	-	4,374
1999						
Sales to unaffiliated customers	\$50,327	\$4,202	\$10,858	\$5,062	\$ -	\$70,449
Intercompany sales	8,354	-	2,016	43	(10,413)	-
Operating profits	2,492	81	1,059	354	52	4,038
Identifiable assets	49,539	857	8,044	5,902	(268)	64,074
Depreciation and amortization	3,802	112	827	302	-	5,043
Capital expenditures	5,953	119	1,323	502	-	7,897
1998						
Sales to unaffiliated customers	\$55,768	\$ 556	\$11,719	\$4,677	\$ -	\$72,720
Intercompany sales	8,340	-	2,281	40	(10,661)	-
Operating profits	5,902	(169)	1,937	190	(172)	7,688
Identifiable assets	47,850	329	8,882	4,032	(74)	61,019
Depreciation and amortization	3,434	-	732	221	-	4,387
Capital expenditures	6,104	(26)	1,254	805	-	8,137

Net foreign currency gains (losses) reflected in results of operations were (\$39), (\$168), and (\$35), for the years 2000, 1999, and 1998, respectively. Operating profit is total sales and other operating income less operating expenses. In computing segment operating profit, interest expense and net miscellaneous income (expense) have not been deducted (added).

Included in U.S. sales to unaffiliated customers were export sales, principally to Canada and Asia, of \$7,134, \$6,056, and \$6,415, during 2000, 1999, and 1998, respectively.

14. Commitments and Contingencies

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

Notes:



Shareholder Information

Corporate Officers

Clyde G. Nixon
Chairman of the Board

Allen J. Carlson
President, CEO

Richard J. Dobbyn
Chief Financial Officer

Jeffrey Cooper
Engineering Manager

Peter G. Robson
General Manager
Sun Hydraulics Limited

Directors

Clyde G. Nixon
Chairman of the Board
Sun Hydraulics Corporation

Allen J. Carlson
President, CEO
Sun Hydraulics Corporation

John S. Kahler
President, CEO
Cincinnati Incorporated

Christine L. Koski
Director
nMetric, LLC

Robert E. Koski
Chairman Emeritus, Founder
Sun Hydraulics Corporation

Taco Van Tijn, Esquire
Solicitor

David N. Wormley, PhD
Dean, Engineering School
Pennsylvania State University

Ferdinand E. Megerlin, Dr.-Ing
Chairman, Joint Managing Director
Linde AG, Industrial Trucks
and Hydraulics Division

Legal Counsel

Shumaker, Loop & Kendrick, LLP
Tampa, Florida

Auditors

PricewaterhouseCoopers LLP
Tampa, Florida

Corporate Headquarters

Sun Hydraulics Corporation
1500 West University Parkway
Sarasota, FL 34243
Phone: 941-362-1200
Fax: 941-355-4497
www.sunhydraulics.com

Investor Relations

If you wish to be placed on Sun Hydraulics mailing or email list for periodic financial releases, please send your request to:

Investor Relations
Sun Hydraulics Corporation
1500 West University Parkway
Sarasota, FL 34243
Phone: 941-362-1200
Fax: 941-355-4497

The Company's Annual Reports, Forms 10-K and 10-Q and earnings releases are available at the Investor section of Sun Hydraulics website: www.sunhydraulics.com

Transfer Agent

SunTrust Bank, Atlanta
Atlanta, Georgia

Common Stock Information

The Common Stock of Sun Hydraulics Corporation is traded on The NASDAQ National Market under the symbol SNHY.

As of March 26, 2001, there were 89 shareholders of record. The number of record holders was determined from the records of the Company's transfer agent and does not include beneficial owners of common stock whose shares are held in the name of various securities brokers, dealers and registered clearing agencies. The Company believes that there are approximately 2,000 beneficial owners of common stock.

As of March 26, 2001, the closing price per share of SNHY stock was \$7.125 and there were 6,384,948 shares outstanding.

Shareholders Annual Meeting

The annual meeting of shareholders will be held Saturday, May 19, 2001, at 10:00 A.M. Eastern Standard Time at Sun Hydraulics Corporation, 701 Tallest Road, Sarasota, Florida 34243.



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