Mig Dobre: Good morning, everyone. Thank you for joining us. My name is a Mig Dobre. I'm Baird's Analyst covering Diversified Industrials and Machinery. It is my pleasure to introduce to you this morning, Sun Hydraulics. As many of you know they are an electrical and hydraulic motion control provider, leveraging superior technology and service capabilities and realizing through-cycle, above-market growth rates.

Joining us today with an update we have the CEO, Wolfgang Dangel, as well as CFO Tricia Fulton. Wolfgang, I'm going to turn it over to you for some remarks and then hopefully we can do a little bit of Q&A. Thanks.

Wolfgang Dangel: Thank you very much, Mig. Good morning, everyone. Thanks Mig, for the introduction. My name is Wolfgang Dangel, I'm the President and CEO of Sun Hydraulics.

Just a brief snapshot of the company here, founded back in 1970s with the IPO about 20 years ago, market cap of around about $1.5 billion. We are currently guiding at about $330 million to $340 million in sales for the year. You see common shares outstanding of $27 million, about 82% held by institutional investors, 12% insider ownership, the rest is with retail.

About two years ago, we evaluated the strategic positioning of the Company and we came up with this Vision statement for 2025. Two years ago we were a $200 million Company. We decided to embark on a pretty aggressive growth path, and want to grow the Company to a critical mass of $1 billion by 2025, all while maintaining superior profitability, as you will see later on from the results that we're generating. In the peer-to-peer comparison, Sun has historically been right at the very top. The Vision is to become a designer and manufacturer of intelligent systems and controls within the two designated technologies that we are presenting, mainly hydraulics and electronics.

If you look at the alignment with the megatrends, we identify three megatrends that probably take very well to our type of business. The first is globalization, predominantly through population growth and the urbanization in Asia. Why? Because it translates into a lot of infrastructure needs for road construction and so forth. That again translates into a lot of construction machinery equipment, which is one of the target markets for the corporation.

The second trend that we're seeing is what we refer to as sophistication of safe machinery and equipment. That has a lot to do with the OEMs, the end-to-end users pushing for more efficient and more productive equipment.

Thirdly, is what we describe as computing power. There's a strong impact of electrification and digitalization creeping into the hydraulics industry as such. So bear in mind, this chart was created two years ago when we were a pure hydraulics company.

On the next chart, I show you what we do today, the scope of our business, we are standing for smart solutions for demanding applications. We represent two businesses. One is the business segment of hydraulics. Historically we've been there 47 years, and then about a year ago, we made a sizable acquisition on the electronics side. I will come to that in a minute.

Year-to-date numbers are here. In sales, these are Q3 year-to-date numbers, the Hydraulics segment represents two-thirds of the business. Hydraulics sales are about $172 million, Electronics is $87 million, and you see the profitability numbers attached to it. On the Hydraulics side we generate north of 25% operating margins. On the Electronics side, it's a little bit less, but still north of 21%.

Below you can see this scope of business. On the Hydraulics side, we are one of the top three manufacturers in cartridge valve technology. These are screwing cartridges that are being utilized in integrated packages that go in subassemblies, and into a wide variety of machinery and equipment. I'll show you some of the applications in a minute.

On the Electronics side, we are a designer and manufacturer of control systems, also for mobile and industrial applications, and we have a nice diversity. We also reach out into recreational applications. I'll also show some examples of that in a minute.

Right now, we are embarking on a strategic execution that is illustrated on this chart. What it actually shows is, traditionally we have a very strong foothold on what we refer to as the traditional hydro-mechanical components. This is what we understand very well from design all the way to manufacturing. We do a lot of the in-house manufacturing ourselves, and we are pretty savvy with regard to the core manufacturing processes. We don't rely on outside suppliers. So, there is quite deep added value within the Company.

We are embarking on this roadmap and we call it the Path of Migration. The industry is moving from the left side of the chart to the right side of the chart. We're developing, jointly between these two engineering teams on the Hydraulics on the Electronics side, smart components. It's an interim step to bring us on the way here to becoming an intelligent control system provider for those applications I talked about.

If I look at our two major brands on the Hydraulics side, we're probably still on the left hand side. If you look at the Hydraulics side, we see our positioning right here, very strong in hydro-mechanical applications. Best-in-class components here.

On the Electronics side, we are already are a system provider. Because we work very closely with OEMs, we are deeply embedded into the applications of OEMs, and develop the packages for them accordingly.

The degree of sophistication means nothing else other than the requirements the machine builder or the OEM has. Again, it goes back to more efficient, more productive equipment, more up time for the machines, and so forth.

If you look at our global footprint, we follow a principle of "in the region, for the region." That means we want to build up the competence in the regional market itself, as close as possible to the customers. That would start with sales and marketing first, and then go into engineering activities, and last but not least, also into manufacturing.

Fifty-nine percent of year-to-date sales are in the Americas, about 22% in Europe, and 19% in the Asia-Pacific region. We have a broad coverage of the global marketplace, with our own representation and own entities in these individual countries and regions.

Let's take a closer look at the hydraulics industry. As such, the total hydraulics industry probably has a size of about $25 billion. That's the blue bubble here. That encompasses everything: warehouse motors, gear boxes, actuators, and so forth. About a third of that is hydraulic valves, and out of that basket, about 20% to 25% (we quantified this at $2 billion), is what we've referred to as compact hydraulics. Compact hydraulics stands for cartridge valve technology, that's what we do. It's a relatively small market, at $2 billion, and we are around about $200 million, a little more this year. Our market share is somewhere in the range of 10% to 13% right now. We are not in the top three manufacturers in this very segment here.

The end markets that we are serving, reflected on the right hand side, in the top three markets are framed in red. They are construction machinery equipment, material handling, and specialized vehicles. This includes utility trucks, fire trucks, ambulance vehicles, and so forth.

We're continuously evolving the product offering within cartridge valve technology. We have one of the broadest product offerings in the marketplace. About 850 product families are using those cartridge valves. We are deeply involved now, and we just announced the launch of a new product family, in the electro-hydraulics area. We do the manifold as well, you integrate the component into the systems of this family. We refer to this as an integrated package.

The market drivers of the hydraulics industry are here, increasing productivity and performance, safety requirements, and reliability requirements. A shift from hydro-mechanical to electro-hydraulic actuation, reduction of noise, vibration, a lot of environmental regulation, and zero leaks still being key factors in hydraulics as well.

If we look at the electronic controls market, we represent two lines of business. Namely, power controls and vehicle technologies. So, that's about a $3.5 billion market. Relevant for us right now, is about half of that, $1.6 billion. As to the addressable market, we quantify it's about half of that again, so it's around about $900 million to a $1 billion marketplace. We are a little bit north of $100 million this year.

End markets that we're addressing you see reflected here, and you see a lot of overlaps with some of the industries I showed you in hydraulics. It's also nice diversification. If you look at the top three segments that we are serving, outlined in the red boxes, it's recreational marine, it's off-road vehicles, and it's motorcycles. So it's a nice diversification compared to the scope of business we did in the hydraulics side in the past.

The product offering on the Electronics side can be allocated to these three product families. Displays and Infotainment has quite trendy stuff in here, and the key differentiator to some of our competitors is that these products have been designed to be spent in very rugged environments.

The second product family here are on the slide is panels and controllers. A wide variety here. Then we have devices and accessories, power distribution models, and so forth. The mantra that we're following is that it's easier solving complex system challenges with expertise and being embedded into the OEM base. We pride ourselves on tremendous customer focus, and it's very high speed. The product development cycles are significantly shorter than most of our competitors.

We acquired this electronics business about a year ago. If you look at the strategic rationale, I would mention three main areas where it meets our long-term strategic vision. Going back to reaching critical mass of $1 billion by 2025, it helps us with regard to the megatrends of electrification and digitalization.

It improves and expands our technology offerings and it helps us to diversify. On the hydraulics side, the challenge over the last 10 years has been that we were trying for three, maximum five, end markets. If those end markets were down at the same time, it was very difficult for the company to grow.

Last, but not least, is the electronics addition. The acquisition of Enovation Controls brought tremendous talent to the table. Thirty-eight percent of the total workforce of about 330 associates are degreed engineers. We have a deep pool of software engineers within the Company. That gives us tremendous opportunity as far as product development is concerned. Again, it's a significant expansion into the growing electronics market, and the transaction was accretive to earnings in year one already.

Just a brief snapshot of the Q3 year-to-date consolidated results. Due to the acquisition, sales grew by 76%. If you just look at organic growth, we grew year-to-date about 27%. The adjusted EBITDA margin you can see, from 25% last year to 27% year-to-date, with the dollars showing an increase of 90%. The corresponding increase also with regard to the adjusted EPS.

Let's take a brief look at the capitalization. We have quite some capabilities, in terms of generating operational and free cash flow, so roughly $40 million in operating cash flow year-to-date. We financed the acquisition last year by drawing against our credit facility for $140 million. We are utilizing the cash flow in order to reduce the facility debt. We've already reduced it to $116 million here. That includes $8 million in the last quarter. As we move forward from here, we still anticipate paying a quarterly dividend to our shareholders.

Next, here is the guidance we gave yesterday; we increased guidance for the second time this year, on the revenue side. As I mentioned before, we're guiding now at $330 million to $340 million consolidated revenue for 2017. The breakdown is about two thirds Hydraulics, one third Electronics. We're looking at the range for the consolidated operating margin between 22% and 24%. It's quite a high ratio for 2017 capital expenditures. That has to do with the expansion of facilities in Asia as well as here in North America. Depreciation and amortization is $11 million to $12 million and $8 to $9 million, respectively.

Last chart. So how do we get close to the Vision 2025, how do we get to that $1 billion? Let's just take a look into the past years. If we take a snapshot of 2005 to 2017, the Hydraulics business roughly grew, on a compounded basis, five percent per year. Back in 2005, we generated 16% operating margin. Over time, we managed to increase that to about 23%.

Then we acquired the Electronics business in 2016. So 2017 is the first full year of having an Electronics segment. As we move forward from this year, we plan on compounded annual growth rates of 8% for Electronics and 9% for Hydraulics, correspondingly. That means the organic business, as it exists now, is expected to go to $450 million for Hydraulics and $200 million for Electronics. That leaves us with a gap of $350 million that we will fill through incremental acquisitions.

That's the end of presentation. Thank you.

Mig Dobre: Thank you, thank you for that. And if you don't mind leaving the last slide up, because I think it's informative to the conversation. One other thing that I've been constantly, pleasantly surprised with in 2017, has been the very strong growth that both your businesses have been able to put up. I think it would be helpful to the audience if you can separate what your outgrowth has been versus the pure end markets. We clearly have seen a cyclical upswing broadening, what is your sense for how sustainable the potential for outgrowth of this company is and so forth?

Wolfgang Dangel: I think, first of all, you're quite right, Mig. There has been quite a bit of tailwind in the economy. If we look at the key end markets that we are serving, all of them have significantly recovered. I use this as an example on the Hydraulics side, the construction machinery markets, globally, there's been a significant rebound of the construction industry in China, for example, which is the single largest market, globally. Also, on the electronics side, if we look at recreational vehicles, there has been quite a bit of tailwind in the economy.

Nevertheless, part of the growth I attribute to some of the initiatives that we launched about two years ago. You are aware of that we took a much more concrete step on the sales side of getting closer to customers with putting our application experts into the field. Historically, on the hydraulics side, we have sold only through channel partners in all of the Americas. Not in Europe, and not in Asia. We changed that about 18 months ago. We started to place experienced application experts into territories across North and South America, and I think that is already showing solid results.

Secondly, I think we've seen, predominantly on the electronics side, a tremendous initiative in terms of launching new products on a continuous basis. I attribute a portion of the 34% year-to-date growth in electronics sales also to that factor. I think the combination of those two, besides the tailwinds of the economy, are the main reasons for the growth.

Mig Dobre: Sure. When talking about electronics business specifically, I saw on a disclosure that 40% of employed staff is engineering. That seems like a very high number to me. Theoretically, that would imply pretty rapid product development cycles. Can you talk about that, and again try to relate this to growth as part of this 2025 Vision?

Wolfgang Dangel: Of course, sure. That's true. So, 38% to be precise, the entire workforce on the Electronics side is 330 people, and 38% of that entire workforce are degreed engineers. Prior to making this acquisition, we did analysis of other potential targets, and no other companies came anywhere near this ratio. That is one very important differentiating factor. If you see how we are utilizing the engineering base, it's pretty impressive. It's deeply embedded in collaborative efforts with the OEMs. We're extremely fast and edge out the competition in the product development process. We're bringing prototypes into the market, we are swarming the customer in this engineering approach, and they pride themselves with conquering complexity. The more complex the problems are on the OEM side, the better. It's actually the sweet spot for this deep engineering confidence that we have on the Electronics side.

Mig Dobre: Lastly, before we go to breakout, you reported earnings just the other day. One other thing that stood out was your commentary in terms of end markets into 2018. Can you give us some puts and takes as to how you think about growth broadly for the end markets, not just for hydraulics?

Wolfgang Dangel: For the majority of those end markets that we target, I think the platform for 2018 is still very positive. The point that we were trying to make on growth is that we didn't want people to get used to growth rates of 34%, 35%, as have been seen year-to-date in 2017. That was the only message that we wanted to convey. I think that some of the end market will show slower growth next year. Again, I would refer to the construction machinery market in Asia, where we have seen staggering growth over the last 18 to 20 months. We will still see solid growth in 2018, but I predict not to the numbers as we have seen over the past 20 months.

Mig Dobre: Right. So to be clear, you are talking about an effect of more difficult comps going forward, as opposed to incremental slowness, or something cyclically changing in the end market.

Wolfgang Dangel: Right. We still expect growth in 2018, but not necessarily at the same rate as 2017.

Mig Dobre: Okay, that's helpful. We're almost out of time here. Please join me in thanking the Sun management team for their presentation.

If you would like to continue your discussion with the management team there's going to be a breakout session in the room right outside here.