Operator: Greetings and welcome to the Sun Hydraulics Corporation Fourth Quarter and Full Year 2016 Financial Results Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder this conference is being recorded.

It is now my pleasure to introduce your host, Ms. Deborah Pawlowski, Investor Relations for Sun Hydraulics. Thank you. You may begin.

Deborah Pawlowski: Thank you Donna and good morning everyone. We certainly appreciate your time today for our fourth quarter and full year 2016 financial results conference call. On the line with me today are Wolfgang Dangel, our President and Chief Executive Officer, and Tricia Fulton, our Chief Financial Officer. Wolfgang and Tricia will be reviewing the results that were published in the press release distributed after yesterday's market close. If you don't have that release, it is available on our website at www.sunhydraulics.com. You'll also find there the slides that will accompany our discussion today.

If you would look to the Slide deck, on Slide 2 you'll find our Safe Harbor statement. As you may be aware, we will make some forward-looking statements during this presentation and also during the Q&A. These statements apply to future events that are subject to risks and uncertainties as well as other factors that could cause actual results to differ materially from where we are today. These risks and uncertainties and other factors are provided in the earnings release as well as other documents filed by the Company with the Securities and Exchange Commission. These documents can be found at our website or at www.sec.gov.

I also want to point out that during today's call, we will discuss some non-GAAP financial measures which we believe are useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results prepared in accordance with GAAP. We have provided reconciliations as comparable GAAP to non-GAAP measures in the tables that accompany today's earnings release, as well as in the slides.

Wolfgang will get started with some highlights for the year and discuss our strategic focus. Tricia will go through the detail of the financial results, and then we'll turn it back to Wolfgang for his perspective on our outlook before we open up the line for questions-and-answers.

So, with that it is now my pleasure to introduce Wolfgang.

Wolfgang Dangel: Thank you Debbie and good morning everyone. Please turn to Slide 3. 2016 was a very exciting year for Sun, one of transformational evolution. We strategically reassessed our future, culminating in our 2025 Vision that we announced to you in November 2016. This Vision will guide us to build scale to reach $1 billion in revenue, while preserving Sun's history of superior profitability and financial strength.

It was the development of this Vision that guided us to the acquisition of Enovation Controls which we closed on December 5. As we discussed in November, Enovation Controls is a leading provider of electronic control, display and instrumentation solutions. The business has a solid reputation for providing innovative, recognized, integrated turnkey solutions that combine proprietary software platforms and customized hardware. It is very complementary to Sun's Hydraulic valve solutions in a number of end markets and applications.

Enovation Controls carries two primary product lines – Power Controls and Vehicle Technology. Power Controls provides panels for off-highway vehicles, stationary equipment and power generation. These products are used in sectors such as construction, agriculture and material handling equipment, as well as utility vehicles, defense vehicles, generators and irrigation. Vehicle Technology provides solutions for recreational vehicles which are used in sectors such as watercraft, snowmobiles, motorcycles and all-terrain vehicles.

With solid profitability and cash flow, the business is also strategically important as it diversifies Sun into new, highly specialized markets and customers seeking complete machine control.

In addition to the acquisition, we invested in our organic business throughout 2016:

- We expanded our global leadership team complementing fresh new talent with bright and energetic knowledge that exists within Sun. We organized ourselves to establish key critical roles to support our growth initiatives.
- We evolved our product development process emphasizing the distinction between innovative and sustaining engineering. The Enovation Controls business also added almost 100 degreed engineers representing approximately one-third of their workforce, bringing a proven track record of new product development and technical innovation.
- We have been investing in field application specialists, increasing our channel partner and direct customer interaction globally.
- We initiated a formal lean enterprise program with dedicated resources for engaging all of our personnel, building a culture of continuous improvement. We are already seeing the benefits of those efforts in terms of further reducing lead times and improving productivity.

Please turn to Slide 4, and I'll provide more detail on our strategic growth plan. As you know, we strive to have US$1 billion in revenue by 2025. As I just described, we have been investing in our foundation to drive that growth. We plan to build on our existing core business and achieve the US$1 billion revenue with approximately half coming from organic growth and the other half resulting out of acquisition. With our acquisition strategy including an electronics focus, we've already acquired part of that with the addition of Enovation Controls.

We intend to broaden our business profile into areas that leverage our unique expertise with higher growth opportunities, since growth in our traditional industries over recent years has been very modest. In addition to electronics, we see natural complementary opportunities in hydraulics and other adjacent technologies such as electromechanical actuation, factory automation, software or products relevant to the Internet-of-Things.

In addition to this product and solution diversification, we are mindful of the need to consider broad geographic opportunities to manage the impact of currency fluctuations given that our customer base is global. Ultimately, our goal is to achieve global technology leadership in the industrial goods sector by 2025. We have a lot of work to do, but we have a clear roadmap and a strong foundation to get us there.

With that strategic perspective, I will now turn the call over to Tricia to review the financial results for the quarter and year.

Tricia Fulton: Thank you, Wolfgang. I'm starting on Slide 6. Fourth quarter sales were $49.9 million, up 13% compared to last year's quarter. This includes $4.1 million for the recently acquired Enovation Controls business, indicating that the organic business grew approximately $1.5 million, or 3%. We didn't have any price increases in 2015 or 2016, so pricing did not affect the comparability. Additionally, the foreign currency translation impact was negligible.

Turning to the bottom line, earnings per share were $0.12, down from $0.19 last year. The current quarter results included several acquisition related items as follows:

- $1.5 million of transaction costs which amount to approximately $0.04 per share;
- $2 million of amortization expense related to acquisition items, which amounts to approximately $0.05 per share. Of that $2 million, $1 million of it is in cost of goods sold and $1 million is in selling, engineering and administrative, or SEA expense; and
- $500,000 of incremental net interest expense primarily due to the cash and debt used to fund the acquisition. That amounts to approximately $0.01 per share.

I will now touch on sales by region, which are designated here in the sales bar charts. You'll also notice that we've inserted a chart in the back of the press release summarizing this information. Experiencing improvement in all of our geographic markets since about September, we realized year-over-year fourth quarter growth in each. In the America, sales grew 14% to $25.3 million, driven by the Enovation Controls business. EMEA realized 4% growth to $13.3 million, and the Asia-Pacific region was up 23%, to $11.3

million. We are especially pleased to see that the investments we're making in China, Korea and India are proving fruitful.

Please turn to Slide 7 for a review of our fourth quarter operating results. Gross profit grew by $1.5 million on the higher sales, partially offset by the $1 million of acquisition related amortization I mentioned previously. This drove a reduction in the gross margins by one percentage point to 34.7%.

SEA expenses increased by $4.3 million, to $12.4 million, including several new items, some of which are non-recurring or non-cash. The increase consists of primarily the following.

- We have a couple of items that were included in our Q4 forecast:
  - $1.5 million of transaction costs for the Enovation Controls acquisition, and
  - $1 million of higher professional fees, CEO transition costs and compensation and employee benefit expenses.
- We also have a couple of items that were not included in our Q4 forecast:
  - $1 million of the amortization expense on acquired intangible assets, and
  - $1.5 million of SEA expense for the Enovation Controls business.

Our Adjusted EBITDA for the quarter grew by $1.6 million resulting in an Adjusted EBITDA margin of 22.3%, compared with 21.4% in last year's quarter. As summarized in the chart at the back of the slides and the press release, this excludes the $1.5 million of Enovation Controls transaction costs as well as the amortization which I mentioned a moment ago.

Please turn to Slide 8 which summarizes the results for the year. 2016 sales were $196.9 million, down 2% compared to 2015. This includes $4.1 million for the recently acquired Enovation Controls business, indicating that the organic business decreased approximately $7.9 million, or 4%. That decrease includes $2.7 million for unfavorable foreign currency translation.

Turning to the bottom line, earnings per share were $0.87, down from the $1.24 last year. These results included the acquisition related items previously described.

Sales for the year varied by region. In the Americas, sales decreased 3% to $94.8 million, EMEA decreased 4% to $58.7 million, and APAC sales were up 4% to $43.4 million.

Please turn to Slide 9 for a review of our 2016 operating results. Gross profit decreased $5.8 million primarily due to lower sales and production volumes as well as the $1 million of acquisition-related amortization I mentioned previously. This drove a reduction in the gross profit margin by 2.2 percentage point to 36.2%.

SEA expenses increased by $6.7 million to $36.9 million including the acquisition-related items previously described. I'll repeat here for convenience:

- $1.5 million of transaction costs,
- $1 million of incremental amortization expense,
- $1.5 million of SEA expense for the Enovation Controls business, and
- $3 million for higher professional fees, CEO transition costs and compensation and employee benefits expense. The CEO transition costs will be completed in the first quarter of 2017.

Our Adjusted EBITDA for the year decreased $9.5 million resulting in an Adjusted EBITDA margin of 24.3%, compared to 28.6% last year.

Please turn to Slide 10 for a review of our capital structure. At the end of 2015, we had a total of $126.1 million in cash and short-term investments, and no debt. We used $60 million of cash and incurred $140 million of debt for the Enovation Controls acquisition. Accordingly, we finished 2016 with $81 million in cash and short-term investments and $140 million of debt. This puts our net debt to net capitalization at 20% at the end of 2016, a very manageable level especially given our very strong cash flow profile.

Given that strong cash flow profile, we generated $38.5 million of operating cash flow during 2016.

I'm pleased to report that our Board authorized a shared distribution once again this year. A total of $1.3 million will be paid out to employees and shareholders. The dividend amount to $0.02 per share and in is addition to our regular quarterly dividend of $0.09 per share.

Wolfgang, I would like to turn it back to you for your perspective and outlook before we open the line for Q&A.

Wolfgang Dangel: Thanks, Tricia. Please turn to Slide 12. As Tricia indicated, we've seen improvement in all of our global regions since about September. This continues to the present time and is very encouraging. As I noted here, the rise in US-PMI reported throughout 2016 is expected to give rise to increased US Industrial Production in 2017, which should bode well for Sun.

In addition to the US, most major economic regions are forecasting accelerating growth in industrial production in 2017. This includes markets important to us – Eastern and Western Europe as well as India. While growth is forecasted for China, it is not expected to be as robust as some of the other regions. However, in China we do believe that we can take market share given a strong positioning of our quality brand in combination with marketing and training investments we've made in recent years.

We have seen growth across a variety of end markets including Energy, Mining, Material Handling and Construction. The US Single Unit Housing market has been showing strength, finishing 2016 with solid year-over-year growth in excess of 12% in the fourth quarter. These factors, as well as the traction we are gaining from our market penetration initiative, give us confidence as we think about our expected financial performance in 2017.

Please turn to Slide 13 for additional thoughts regarding our outlook. The growth trends sited on the prior slide of course do not take into consideration changes in economic policy that may be implemented by the new US Administration, so we will monitor those changes going forward. Additionally, we are cautious about geo-political risks, with major upcoming elections in the Netherlands, France, Germany, and most likely in Italy that may have a significant impact on the future viability of the European Union, especially given what appears to be a recent rise in global populism.

Please proceed to Slide 14 where we summarized our guidance for 2017. You'll notice that we are providing guidance for the entire year as opposed to only the next quarter which we have historically done. We believe this approach provides better clarity on our expected financial performance, especially as it will include our Enovation Controls business for the entire year. We are forecasting revenue between US$295 million and US$310 million, representing 7% to 13% growth over pro forma 2016 combined revenue.

We will be reporting in two segments, with the Enovation Controls business comprising the significant majority of our Electronics segment, and most of the historical Sun business comprising our Hydraulics segment. We currently estimate our Hydraulics segment revenue to be between US$205 million and US$215 million and our Electronics segment revenue to be between US$90 million and US$95 million. We estimate that our consolidated operating margin will be between 20% and 22% before acquisition-related amortization expense. Our consolidated interest expense will be between US$4.2 million and US$4.7 million and our effective tax rate will be between 32% and 34%.

Finally, we anticipate capital expenditures between US$8 million and US$10 million, depreciation between US$12 million and US$13 million, and amortization between US$8 million and US$9 million.

So, with that, let's open up the line for Q&A.

Operator: Thank you. The floor is now for questions. If you would like to ask a question, please press star, one on your telephone keypad at this time. A confirmation tone will indicate that your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. Once again, that is star, one to register questions at this time.

Our first question is coming from Mig Dobre of Robert W. Baird. Please proceed with your question.

Joe Grabowski: Good morning Wolfgang and Tricia. This is Joe Grabowski on for Mig this morning.

Wolfgang Dangel: Good morning Joe.

Tricia Fulton: Good morning Joe.

Joe Grabowski: Good morning. Just a quick clarification on the guidance that you just ran through. The Electronics segment, it's not all Enovation, so maybe of that $90 million to $95 million, how much is Enovation and how much is legacy Sun businesses?

Wolfgang Dangel: Yes. So, you're right, Joe, there is a legacy electronics business of Sun High Country Tek, HCT, which amounts to about US$4 million.

Joe Grabowski: I see, okay, that's helpful. Then, walking through the math on Enovation. So, Enovation sales are going to be, at the mid-point of the guidance range, a little below $90 million, and then the margin on Enovation, I remember when you made the acquisition, you said Enovation's operating margins were similar to your legacy business. Is that going to be true for 2017? Will Enovation's margins be in that 20% to 22% range?

Wolfgang Dangel: Yes. It's quite similar to ours. It's not quite on the same lines, though. As you might recall, they have actually a higher gross profit margin than Sun has, but then there are more engineering and selling expenses.

Joe Grabowski: Okay.

Wolfgang Dangel: But pretty much the statement that we made in November is true and is embedded in these numbers.

Joe Grabowski: Okay. So, if I assume maybe like a 20% operating margin for Enovation and then I subtract the $8 million to $9 million of amortization, I subtract about $6 million of incremental interest expense, I tax effect it, I get to Enovation accretion in 2017, all in, of maybe $0.10, and I'm just wondering how that compares to the $0.25 to $0.35 of GAAP EPS accretion that you guys talked about at the time of the acquisition?

Tricia Fulton: We did not run through those numbers at the EPS level in particular when we were doing the guidance. We were focused more on the operating margin numbers and looking at the EBITDA. I'll have to run through those specifically. There is some noise in those numbers, obviously from the amortization that's going to come from the intangibles. When we roll these up, in total there is significant amortization related to the identified intangible assets that came with the acquisition.

Joe Grabowski: Sure. Were you expecting that level of amortization when you gave the $0.25 to $0.35 guidance, or is that higher than you had anticipated?

Tricia Fulton: It's a little higher than what we had anticipated. We didn't have that analysis fully completed at that time. Actually, we've left the measurement period open, so that we do have some flexibility if we recognize that those assets should be re-valued over the next year as well, so you will see that in the 10-K as well.

Joe Grabowski: Okay. That's helpful, and then switching to the legacy Sun business. So, that business' operating margin is going to be slightly higher than 20% to 22%. If I look back to 2015 when you had around $201 million of sales, operating margin was about 23.5%, and so, there was a lot of noise in the numbers in 2016 with the CEO transition costs and deal-related costs and so forth. But, if I compare 2017 to 2015, your sales guidance is higher and your operating margin guidance is lower. So, are there some unusual costs over and above the one quarter CEO transition costs that might be impacting the legacy margins in 2017?

Wolfgang Dangel: No. Joe, there is no additional expenses embedded into that, and once we get to an apples-to-apples comparison situation here, you will see pretty much the same profitability level that you are referring to back in 2015. That's the indication of the calculations we are seeing here. We have a little bit higher expenses right now because we're investing heavily in engineering, but for that we get the return in additional profitable sales, and I think that's reflected here in the guidance as well for 2017.

Joe Grabowski: Sure. That makes sense. Couple of more questions. The full year guidance is very helpful, especially with all the changes to the business. What I was just wondering, could you give any color on quarterly pacing of sales, and maybe specifically Q1? What is your outlook for sales or anything as far as the quarterly pacing goes?

Wolfgang Dangel: Of course, Joe. So, as I mentioned before, we have seen an uptick in business since September of last year. We are very encouraged by what we're seeing now, right now during the course of the first quarter of 2017, and I think the good news is we are seeing it across the spectrum. It's coming from various end markets, as well as from all the regions around the world. The US is rebounding particularly strong. We have to see whether that can be sustained, but everything we are seeing is reasonably positive right now.

Joe Grabowski: Great. Okay. Two more questions from me. When you announced the Enovation deal, you talked about a $35 million favorable tax benefit over time. It doesn't seem to be hitting this year because your tax rate guidance is 33% to 35%. So, any updated thoughts on the tax benefit from the deal?

Tricia Fulton: Yes. We still believe that we're going to get that level of tax benefit and there are benefits that are being recognized in the 2017 estimates that we gave. The part that we're still working through are the state effects of having additional states brought in that are driving up the tax rate a little bit. So, the tax benefit is offset somewhat by the additional state tax that we'll recognize as we're going through and bringing in all the additional states under the Enovation umbrella.

Joe Grabowski: I see. Okay. Final question, you've owned Enovation for a few months now. Any early learnings or any surprises from the last time you talked about the Company and the transaction?

Wolfgang Dangel: No negative surprises at all. I have to say things are actually going smoother than we had anticipated for phase one, and we are just getting a daily reconfirmation of what we believed and saw during the feasibility space about a year ago. So, things are looking rather positive.

Joe Grabowski: Great. Okay. Thanks for taking my questions. Good luck in 2017.

Tricia Fulton: Thank you.

Wolfgang Dangel: Thank you.

Operator: Thank you. Once again, that is star, one to register any audio questions at this time. For participants that are participating via the webcast, you can use the chat box located in the middle of your screen to submit a question electronically to today's speakers.

Our next question is coming from Jon Braatz of Kansas City Capital. Please proceed with your question.

Jon Braatz: Good morning Wolfgang and Tricia.

Wolfgang Dangel: Good morning, Jon.

Tricia Fulton: Good morning, Jon.

Jon Braatz: Wolfgang, I just want to touch base on your sales guidance of about $205 million to $215 million for the legacy business. That suggests growth of 10% for the year, something of that magnitude, and at least some of the other industrial companies that I talk to, that 10% growth is in excess of what some of the other companies are guiding. My question is, does that estimate assume that there is going to be some increased sales momentum as we go through the year, and then secondly, what does that suggest about market share gains? What part of that growth rate that you're expecting comes from market share?

Wolfgang Dangel: It's a good question Jon. So, to the first part of your question, we have a bit of seasonality in the business. As you know historically the second quarter is stronger than the first one. So, obviously having these encouraging times during the first quarter makes us pretty confident for the second quarter as well. With regards to market share gain, when you refer to the legacy business, we would talk about cartridge valve technology here. So, we expect cartridge valve technology to grow probably somewhere in the range of between 5% and 10% this year. So, that assumes that we are taking some market share, and I would say predominantly in Asia, but maybe also a little bit here in North America. So, that's the assumption based on the guidance that we are giving you on our virtual growth.

Jon Braatz: Okay. No price increases, is that correct?

Wolfgang Dangel: No price increases, at least at this stage, there is very little pressure from the supplier side on commodity price increases. There is no need for us to pass anything on to the market place. As I mentioned earlier, Jon, we started a lean enterprise program and we are looking for efficiency and productivity gains internally here. So, we don't feel this is the environment to impose any price increases on our customers. I think this is the right opportunity here to focus on market share gain in the individual end market.

Jon Braatz: Okay. Tricia, on the balance sheet, some short-term and long-term considerations coming from the Enovation acquisition. What are the metrics associated with that? Are they sales oriented, profitability oriented, return on investment oriented? What can you tell us about that consideration?

Tricia Fulton: Yes, the consideration is what we call the earn-out on the Enovation acquisition and the metrics for those are 75% related to revenue targets being hit and 25% related to EBITDA targets being hit for each of the three measurement earn-out periods.

Jon Braatz: Okay, and is there longer term consideration, is that over let's say a two, three or five year period? How long of a period is there?

Tricia Fulton: The total earn-out period is 27 months. So, it's broken down into three nine months segments with the first payment and earn-out measurement period ending on August 31, 2017.

Jon Braatz: Okay, then lastly, Tricia the amortization that you estimate between $8 million and $9 million for 2017, is that incremental and associated with the Enovation acquisition?

Tricia Fulton: The vast majority of it is. There's a very small portion that's related to identifiable intangibles for HCT and WhiteOak that were identified at the time of those acquisitions, but the vast majority is related to the intangibles related to the acquisition of Enovation. Most of them have useful lives of around 15 years, but they range anywhere from 5 to 20 years.

Jon Braatz: Okay. Was any of the amortization that we saw in the fourth quarter one-time in nature or is this the write-off of the intangibles for the first month?

Tricia Fulton: The portion that we saw hit in the cost of goods sold section was what I would consider one-time in nature. There might be a little bit that floats into Q1 as well, but it's related to the step-up on inventories that we acquired. So, as soon as they turn it, that goes away.

Jon Braatz: Yes, okay. All right Tricia, thank you very much.

Tricia Fulton: Thank you.

Operator: Thank you. At this time, I'd like to turn the floor back over to Management for any additional or closing comments.

Wolfgang Dangel: Thank you again for your participation this morning. I'm proud to have the opportunity to lead this outstanding team and appreciate your interest in Sun Hydraulics. We look forward to updating you on our first quarter progress in early May. Thanks again, and have a great day.

Operator: Ladies and gentlemen, thank you for your participation. This concludes today's teleconference. You may disconnect your lines at this time and have a wonderful day.