

PEAK INTERNATIONAL LTD
Form 10-Q
November 15, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2004

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 0-29332

PEAK INTERNATIONAL LIMITED

(Exact Name of Registrant as Specified in its Charter)

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Incorporated in Bermuda with limited liability
(State or other jurisdiction of

incorporation or organization)

44091 Nobel Drive, P.O. Box 1767, Fremont, California
(Address of principal executive offices)

None
(I.R.S. Employer

Identification Number)

94538
(Zip Code)

(510) 449-0100

(Registrant's telephone number)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of November 11, 2004

| <u>Class</u> | <u>Outstanding at November 11, 2004</u> |
|--------------------------------|---|
| Common Stock, \$0.01 Par Value | 12,408,166 |

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

Condensed Consolidated Statements of Operations

(in thousands of United States Dollars, except share and per share data)

| | Three Months Ended September 30, | | | |
|---|----------------------------------|---------|-------------|--------|
| | 2004 | | 2003 | |
| | (Unaudited) | | (Unaudited) | |
| Net Sales | \$ 16,787 | 100.0% | \$ 15,224 | 100.0% |
| Cost of Goods Sold (Note 2) | 13,989 | 83.3% | 11,366 | 74.7% |
| Gross Profit | 2,798 | 16.7% | 3,858 | 25.3% |
| Selling and Marketing (Note 3) | 3,036 | 18.1% | 2,810 | 18.5% |
| General and Administrative | 1,671 | 10.0% | 1,681 | 11.0% |
| Research and Development | 39 | 0.2% | 61 | 0.4% |
| Loss from operations | (1,948) | (11.6)% | (694) | (4.6)% |
| Other Income (Expenses) net | (84) | (0.5)% | 63 | 0.4% |
| Interest Income | 44 | 0.3% | 38 | 0.3% |
| Loss Before Income Taxes | (1,988) | (11.8)% | (593) | (3.9)% |
| Income Tax (Expense) Benefit (Note 4) | 491 | 2.9% | (6) | (0.0)% |
| Net Loss | \$ (1,497) | (8.9)% | \$ (599) | (3.9)% |
| LOSS PER SHARE (Note 9) | | | | |
| Basic | \$ (0.12) | | \$ (0.05) | |
| Diluted | \$ (0.12) | | \$ (0.05) | |
| Weighted Average Number of Shares Outstanding | | | | |
| Basic | 12,396,000 | | 12,075,000 | |
| Diluted | 12,396,000 | | 12,075,000 | |

(See accompanying notes to Unaudited Condensed Consolidated Financial Statements)

Condensed Consolidated Statements of Operations

(in thousands of United States Dollars, except share and per share data)

| | Six Months Ended September 30, | | | |
|--|--------------------------------|---------------|-----------------|---------------|
| | 2004 | | 2003 | |
| | (Unaudited) | | (Unaudited) | |
| Net Sales | \$ 34,581 | 100.0% | \$ 30,286 | 100.0% |
| Cost of Goods Sold (Note 2) | 26,463 | 76.5% | 21,951 | 72.5% |
| Gross Profit | 8,118 | 23.5% | 8,335 | 27.5% |
| Selling and Marketing (Note 3) | 6,184 | 17.9% | 5,592 | 18.5% |
| General and Administrative | 3,374 | 9.8% | 3,223 | 10.6% |
| Research and Development | 85 | 0.2% | 104 | 0.3% |
| Loss from operations | (1,525) | (4.4)% | (584) | (1.9)% |
| Other Income (Expenses) net | (164) | (0.5)% | 4 | 0.0% |
| Interest Income | 77 | 0.2% | 88 | 0.3% |
| Loss Before Income Taxes | (1,612) | (4.7)% | (492) | (1.6)% |
| Income Tax (Expense) Benefit (Note 4) | 439 | 1.3% | (185) | (0.6)% |
| Net Loss | \$ (1,173) | (3.4)% | \$ (677) | (2.2)% |
| LOSS PER SHARE (Note 9) | | | | |
| Basic | \$ (0.09) | | \$ (0.06) | |
| Diluted | \$ (0.09) | | \$ (0.06) | |
| Weighted Average Number of Shares Outstanding | | | | |
| Basic | 12,379,000 | | 12,208,000 | |
| Diluted | 12,379,000 | | 12,208,000 | |

(See accompanying notes to Unaudited Condensed Consolidated Financial Statements)

Condensed Consolidated Balance Sheets

(in thousands of United States Dollars, except share and per share data)

| | September 30, 2004 | March 31, 2004 |
|--|-----------------------|-------------------|
| | (Unaudited) | |
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 20,433 | \$ 20,303 |
| Accounts receivable net of allowance for doubtful accounts of \$228 at September 30, 2004 and \$237 at March 31, 2004 | 12,537 | 12,393 |
| Inventories (Note 5) | 13,420 | 13,547 |
| Other receivables, deposits and prepayments | 1,260 | 1,050 |
| Income taxes receivable (Note 6) | 26 | |
| Total Current Assets | 47,676 | 47,293 |
| Asset to be disposed of by sale (Note 15) | 5,230 | 5,230 |
| Property, Plant and Equipment net | 28,314 | 28,246 |
| Land Use Right | 752 | 761 |
| Deposits for Acquisition of Property, Plant and Equipment | 35 | 969 |
| Income taxes receivable (Note 6) | | 5,085 |
| Other deposit (Note 7) | 301 | 301 |
| TOTAL ASSETS | \$ 82,308 | \$ 87,885 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | | |
| -Trade | \$ 5,659 | \$ 4,436 |
| -Property, plant and equipment | 226 | 628 |
| Accrued payroll and employee benefits | 1,615 | 1,480 |
| Accrued other expenses | 1,134 | 1,168 |
| Income taxes payable | 242 | 5,858 |
| Total Current Liabilities | 8,876 | 13,570 |
| Deferred Income Taxes | 1,572 | 1,670 |
| Total Liabilities | 10,448 | 15,240 |
| Commitments and Contingencies (Note 13) | | |
| Shareholders Equity: | | |
| Common stock, \$0.01 par value; authorized 100,000,000 shares; issued and outstanding 12,397,216 shares at September 30, 2004, and 12,312,691 shares at March 31, 2004 | 124 | 123 |
| Additional paid-in capital | 27,048 | 26,702 |
| Retained earnings | 45,849 | 47,022 |
| Accumulated other comprehensive loss | (1,161) | (1,202) |
| Total shareholders equity | 71,860 | 72,645 |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | \$ 82,308 | \$ 87,885 |

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(See accompanying notes to Unaudited Condensed Consolidated Financial Statements)

Condensed Consolidated Statements of Cash Flows

(in thousands of United States Dollars)

| | Six Months Ended | |
|---|------------------|-------------|
| | September 30, | |
| | 2004 | 2003 |
| | (Unaudited) | (Unaudited) |
| Operating activities: | | |
| Net loss | \$ (1,173) | \$ (677) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,384 | 3,115 |
| Deferred income taxes | (98) | 121 |
| Loss on disposal/write-off of property, plant and equipment | 82 | 489 |
| Allowance for doubtful accounts | (9) | (41) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (135) | (379) |
| Inventories | 127 | 250 |
| Other receivables, deposits and prepayments | (210) | (199) |
| Income taxes receivable | 5,059 | (686) |
| Accounts payable-trade | 1,223 | 374 |
| Accrued payroll, employee benefits and other expenses | 101 | 252 |
| Income taxes payable | (5,616) | 61 |
| Net cash provided by operating activities | 2,735 | 2,680 |
| Investing activities: | | |
| Acquisition of property, plant and equipment | (3,927) | (3,077) |
| Proceeds on disposal of property, plant and equipment | 12 | 12 |
| Decrease /(increase) in deposits for acquisition of property, plant and equipment | 934 | (56) |
| Net cash used in investing activities | (2,993) | (3,121) |
| Financing activities: | | |
| Proceeds from issuance of common stock | 347 | 474 |
| Payment for repurchase of common stock | - | (2,416) |
| Net cash provided by (used in) financing activities | 347 | (1,942) |
| Net increase /(decrease) in cash and cash equivalents | 89 | (2,383) |
| Cash and cash equivalents at beginning of period | 20,303 | 25,928 |
| Effects of exchange rate changes on cash and cash equivalents | 41 | (134) |
| Cash and cash equivalents at end of period | \$ 20,433 | \$ 23,411 |
| Supplemental cash flow information: | | |
| Cash paid during the period | | |
| Interest | \$ 216 | \$ 689 |
| Income taxes | - | - |

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(See accompanying notes to Unaudited Condensed Consolidated Financial Statements)

Notes to Condensed Consolidated Financial Statements

(in thousands of United States Dollars, except share and per share data, unaudited)

(1) Organization and basis of presentation

Peak International Limited (the Company) was incorporated as an exempted company with limited liability in Bermuda under the Companies Act 1981 of Bermuda (as amended) on January 3, 1997. The subsidiaries of the Company are principally engaged in the manufacture and sale of precision engineered packaging products, such as matrix and disk drive trays, shipping tubes, reels and carrier tapes, leadframe boxes and interleaves used in the storage and transportation of semiconductor devices and other electronic components. The Company's principal production facilities are located in the People's Republic of China (the PRC) and the Company maintains offices in Hong Kong, Malaysia, Singapore, Taiwan, and the United States of America.

The unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intra-group balances and transactions have been eliminated on consolidation.

The accompanying condensed consolidated financial information has been prepared by the Company without being audited, in accordance with the instructions to Form 10-Q and therefore does not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in accordance with accounting principles generally accepted in the United States of America.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect reported amounts of certain assets, liabilities, revenues and expenses as of and for the reporting periods. Actual results could differ from those estimates. Differences from those estimates are reported in the period they become known.

The unaudited condensed consolidated financial statements reflect all adjustments (including normal recurring adjustments) which in the opinion of management are required for a fair presentation of the Company's interim results. The results for interim periods are not necessarily indicative of the results that may be achieved in the entire year. These condensed consolidated financial statements and notes thereto should be read together with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended March 31, 2004.

(2) Cost of goods sold

Included therein was \$50 (unaudited) and \$108 (unaudited) respectively (2003-\$443 and \$489, unaudited) write-off of machinery and molds due to technological obsolescence and capacity under-utilization for the quarter and for the six months ended September 30, 2004.

(3) Delivery and freight expenses

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For the quarter and for the six months ended September 30, 2004, the Company incurred delivery and freight expenses of approximately \$869 (unaudited) and \$1,763 (unaudited) (2003 \$693 and \$1,444, unaudited) respectively, which have been included as part of selling and marketing expenses.

(4) Income tax (expense) / benefit

Income is subject to taxation in the various countries in which the Company and its subsidiaries operate. A net gain of \$340 was recognized as a result of a settlement with the Inland Revenue Department of Hong Kong for prior years' tax disputes when Peak was allowed a significant relief on related interest charges.

(5) Inventories

| | September 30, 2004 | March 31, 2004 |
|----------------|-------------------------------|---------------------------|
| | <u>(Unaudited)</u> | |
| Raw materials | \$ 6,686 | \$ 7,332 |
| Finished goods | 6,734 | 6,215 |
| | <u>\$ 13,420</u> | <u>\$ 13,547</u> |

Notes to Condensed Consolidated Financial Statements (continued)

(in thousands of United States Dollars, except share and per share data, unaudited)

(6) Income Taxes Receivable

As at March 31, 2004, this represents approximately \$5,061 of tax reserve certificates purchased from the Inland Revenue Department of Hong Kong (IRD) in respect of prior year taxes that were under examination by the IRD. In the quarter ended September 30, 2004, these tax reserve certificates have been utilized to pay for those prior year taxes as a result of a settlement reached with the IRD.

(7) Other Deposit

This represents the security bond placed at a Taiwanese court in order to obtain an anti-injunction order in respect of a potential patent dispute in Taiwan. See Note 13(a) Litigation. Management of the Company does not expect the case to be settled within 12 months and therefore the amount was classified as a non-current asset.

(8) Stock Options

Option activity relating to the Company's stock option plan is summarized as follows (unaudited):

| | Outstanding Options | |
|-----------------------------------|---------------------------------|--|
| | Number of Shares | Weighted average exercise price per share |
| Outstanding at April 1, 2004 | 2,810,313 | \$ 5.99 |
| Granted | 396,420 | 5.10 |
| Exercised | (58,210) | 3.96 |
| Forfeited | (49,900) | 7.93 |
| Outstanding at June 30, 2004 | 3,098,623 | 5.88 |
| Granted | | |
| Exercised | (2,559) | 3.52 |
| Forfeited | (382,335) | 7.33 |
| Outstanding at September 30, 2004 | 2,713,729 | 5.68 |

Outstanding Options

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| | Number of Shares | Weighted average exercise price per share |
|-----------------------------------|------------------------|--|
| Outstanding at April 1, 2003 | 3,537,459 | \$ 5.96 |
| Granted | 8,000 | 3.87 |
| Forfeited | (3,825) | 8.94 |
| Outstanding at June 30, 2003 | 3,541,634 | 5.95 |
| Granted | 184,000 | 5.24 |
| Exercised | (100,000) | 3.66 |
| Forfeited | (254,288) | 6.55 |
| Outstanding at September 30, 2003 | 3,371,346 | 6.25 |

Notes to Condensed Consolidated Financial Statements (continued)

(in thousands of United States Dollars, except share and per share data, unaudited)

(9) Loss Per Share

The following is a reconciliation of the numerator and the denominator of the basic loss per share:

| | Three Months Ended | |
|---|--------------------|-------------------|
| | September 30, | |
| | 2004 | 2003 |
| | (Unaudited) | (Unaudited) |
| Numerator: | | |
| Net loss available to common shareholders | \$ (1,497) | \$ (599) |
| Denominator: | | |
| Weighted average number of shares outstanding | | |
| Basic | 12,396,265 | 12,074,873 |
| Assumed exercise of stock options | | |
| Diluted | 12,396,265 | 12,074,873 |
| | | |
| | Six Months Ended | |
| | September 30, | |
| | 2004 | 2003 |
| | (Unaudited) | (Unaudited) |
| Numerator: | | |
| Net loss available to common shareholders | \$ (1,173) | \$ (677) |
| Denominator: | | |
| Weighted average number of shares outstanding | | |
| Basic | 12,378,571 | 12,207,529 |
| Assumed exercise of stock options | | |
| Diluted | 12,378,571 | 12,207,529 |

For the quarter ended and six months ended September 30, 2004 and 2003, exercise of all outstanding stock options would have been anti-dilutive and such stock options were therefore not included in the computation of diluted losses per share.

Notes to Condensed Consolidated Financial Statements (continued)

(in thousands of United States Dollars, except share and per share data, unaudited)

(10) Comprehensive Loss

The Company's comprehensive loss consists of the following:

| | Three Months Ended | |
|--------------------------------------|--------------------|-------------|
| | September 30, | |
| | 2004 | 2003 |
| | (Unaudited) | (Unaudited) |
| Net loss | \$ (1,497) | \$ (599) |
| Other comprehensive income / (loss): | | |
| Foreign currency translation | 14 | (102) |
| Comprehensive loss | \$ (1,483) | \$ (701) |
| | | |
| | Six Months Ended | |
| | September 30, | |
| | 2004 | 2003 |
| | (Unaudited) | (Unaudited) |
| Net loss | \$ (1,173) | \$ (677) |
| Other comprehensive income / (loss): | | |
| Foreign currency translation | 41 | (132) |
| Comprehensive loss | \$ (1,132) | \$ (809) |
| | | |
| | September 30, | March 31, |
| | 2004 | 2004 |
| | (Unaudited) | (Unaudited) |
| Accumulated other comprehensive loss | | |
| Foreign currency translation | \$ (1,161) | \$ (1,202) |

(11) Employee Stock Purchase and Option Plans

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During the quarter ended September 30, 2004, under the 1998 Stock Option Plan the Company did not issue any stock options to officers or employees of the Company. Pursuant to the Company's 2000 Employee Stock Purchase Plan, the Company issued to officers and employees of the Company 11,832 shares at a price of \$4.216 for contributions made during the quarter ended June 30, 2004, and authorized the issuance of 9,800 shares at a price of \$4.2075 to officers and employees for contributions made during the quarter ended September 30, 2004.

The Company accounts for stock-based compensation awarded to employees using the intrinsic value method prescribed in Accounting Principles Board Opinions (APB) No. 25 Accounting for Stock Issued to Employees and related interpretations. No stock-based employee compensation cost is reflected in net profit/(loss), as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

Notes to Condensed Consolidated Financial Statements (continued)

(in thousands of United States Dollars, except share and per share data, unaudited)

(11) Employee Stock Purchase and Option Plans (continued)

If the Company had accounted for its stock option plans and the stock purchase plan by recording compensation based on the fair value at grant date for such awards consistent with the method of Statement of Financial Accounting Standards (SFAS) No. 123 Accounting for Stock-Based Compensation, the Company's net loss and loss per share would have been increased/decreased as follows:

| | Three months ended | |
|---|--------------------|-------------|
| | September 30, | |
| | 2004 | 2003 |
| | (Unaudited) | (Unaudited) |
| Net loss, as reported | \$ (1,497) | \$ (599) |
| Add: compensation expense released under SFAS no. 123, net of tax | \$ 642 | \$ 327 |
| Pro forma net loss | \$ (855) | \$ (272) |
| Pro forma losses per share | | |
| - Basic | \$ (0.07) | \$ (0.02) |
| - Diluted | \$ (0.07) | \$ (0.02) |
| | Six months ended | |
| | September 30, | |
| | 2004 | 2003 |
| | (Unaudited) | (Unaudited) |
| Net loss, as reported | \$ (1,173) | \$ (677) |
| Add: compensation expense released under SFAS no. 123, net of tax | \$ 666 | \$ 151 |
| Pro forma net loss | \$ (507) | \$ (526) |
| Pro forma losses per share | | |
| - Basic | \$ (0.04) | \$ (0.04) |
| - Diluted | \$ (0.04) | \$ (0.04) |

(12) Share Repurchase

In September 2000, the Board of Directors of the Company authorized the repurchase by the Company of up to \$10,000 of its common stock at prices not to exceed 150% of the Company's net asset value per share. Common stock repurchased will be cancelled immediately. The excess of purchase price over par value is charged to additional paid-in capital.

The Company purchased 656,186 shares from Mr. T. L. Li for \$2,400 on May 5, 2003. The shares repurchased from Mr. T. L. Li were immediately retired. The shares were purchased from Mr. T. L. Li at a per share price of \$3.66 per share, which represented a 5% discount from the \$3.85 closing price of the shares on the NASDAQ National Market on that date. The excess of purchase price over par value was recorded as

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a reduction to additional paid-in capital.

In addition, the Company repurchased 4,000 shares at an average price of \$3.94 in the first quarter of fiscal 2004. There was no repurchase of shares for the quarter ended and six months ended September 30, 2004.

Notes to Condensed Consolidated Financial Statements (continued)

(in thousands of United States Dollars, except share and per share data, unaudited)

(13) Commitments and Contingencies

(a) Litigation

R.H. Murphy Co., Inc. (Murphy) is the owner of U.S. Reexamined Patent 5,400,904 C1 and certain corresponding foreign patents, which patents are directed to specific features in trays used to carry integrated circuits. Murphy has notified the Company and certain of its customers that it believes these patents are infringed by certain integrated circuit trays that the Company provided to its customers, and indicated that licenses to these patents are available. The Company does not believe that any valid claim of these patents is infringed, and is proceeding consistent with that belief.

On July 8, 2002, the Company placed a security bond of approximately \$301 at a Taiwanese district court in connection with a preliminary injunction order so that the Company can continue to sell trays in Taiwan without being interrupted by Murphy and its three distributors in Taiwan. The Taiwanese district court granted the order in June 2002, after which Murphy's three local distributors filed an appeal with the Taiwanese high court against the grant of the order by the district court. In December 2002, the high court ruled that the anti-injunction order should be revoked. In February 2003, the Company filed an appeal to the Taiwanese Supreme Court which was granted and resulted in the dismissal of Murphy's local distributors' appeals. The grant of the preliminary injunctive relief against the Company or its Taiwan customers during the pendency of the underlying litigation. In addition, in October 2002, the Company filed a civil suit against Murphy with the Taiwanese district court seeking permanent relief in connection with the preliminary injunction order. An additional security bond of approximately \$13 was placed with the Taiwanese court in connection with the underlying civil suit, which was later increased by approximately \$24. If the Company's effort to receive permanent relief is not successful, the Company may be required to forfeit the bonds and Murphy and its distributors in Taiwan may assert patent infringement claims against the Company which, if successful, could prevent the Company from selling certain of its products in Taiwan and could result in monetary damages. In December 2001, the Company also filed an action with the Taiwanese Intellectual Property Office to invalidate Murphy's patent. In February 2002, the Company also filed a complaint for unfair competition with the Fair Trade Commission against Murphy. The Fair Trade Commission dismissed the action and the Company has filed an appeal. That appeal was dismissed by the Executive Yuan and the Company has filed an administrative suit contesting the dismissal. At present, the outcome of this potential patent dispute cannot be predicted with reasonable particularity and no impact to the financial statements has been reflected in this respect.

(b) Commitments

At September 30, 2004, the Company had commitments for capital expenditures of approximately \$270.

Notes to Condensed Consolidated Financial Statements (continued)

(in thousands of United States Dollars, except share and per share data, unaudited)

(14) Segment Information

| | <u>Hong Kong & the PRC</u> | <u>United States</u> | <u>Other Asian countries</u> | <u>Eliminations</u> | <u>Consolidated</u> |
|---|------------------------------------|--------------------------|----------------------------------|---------------------|---------------------|
| Quarter ended September 30, 2004 (unaudited) | | | | | |
| Net sales to third parties | \$ 8,633 | \$ 953 | \$ 7,201 | \$ | \$ 16,787 |
| Transfer between geographic areas | 7,862 | | 563 | (8,425) | |
| Total net sales | <u>\$ 16,495</u> | <u>\$ 953</u> | <u>\$ 7,764</u> | <u>\$ (8,425)</u> | <u>\$ 16,787</u> |
| (Loss) Income before tax | <u>\$ (2,017)</u> | <u>\$ 1</u> | <u>\$ (167)</u> | <u>\$ 195</u> | <u>\$ (1,988)</u> |
| Quarter ended September 30, 2003 (unaudited) | | | | | |
| Net sales to third parties | \$ 7,006 | \$ 733 | \$ 7,485 | \$ | \$ 15,224 |
| Transfer between geographic areas | 8,348 | | 820 | (9,168) | |
| Total net sales | <u>\$ 15,354</u> | <u>\$ 733</u> | <u>\$ 8,305</u> | <u>\$ (9,168)</u> | <u>\$ 15,224</u> |
| (Loss) Income before tax | <u>\$ (613)</u> | <u>\$ 123</u> | <u>\$ 78</u> | <u>\$ (181)</u> | <u>\$ (593)</u> |
| Six months ended September 30, 2004 (unaudited) | | | | | |
| Net sales to third parties | \$ 17,553 | \$ 2,087 | \$ 14,941 | \$ | \$ 34,581 |
| Transfer between geographic areas | 16,125 | | 1,287 | (17,412) | |
| Total net sales | <u>\$ 33,678</u> | <u>\$ 2,087</u> | <u>\$ 16,228</u> | <u>\$ (17,412)</u> | <u>\$ 34,581</u> |
| (Loss) Income before tax | <u>\$ (1,504)</u> | <u>\$ 38</u> | <u>\$ (327)</u> | <u>\$ 181</u> | <u>\$ (1,612)</u> |
| Six months ended September 30, 2003 (unaudited) | | | | | |
| Net sales to third parties | \$ 14,046 | \$ 1,716 | \$ 14,524 | \$ | \$ 30,286 |
| Transfer between geographic areas | 15,913 | | 1,253 | (17,166) | |
| Total net sales | <u>\$ 29,959</u> | <u>\$ 1,716</u> | <u>\$ 15,777</u> | <u>\$ (17,166)</u> | <u>\$ 30,286</u> |
| (Loss) Income before tax | <u>\$ (507)</u> | <u>\$ 200</u> | <u>\$ 13</u> | <u>\$ (198)</u> | <u>\$ (492)</u> |

Notes to Condensed Consolidated Financial Statements (continued)

(in thousands of United States Dollars, except share and per share data, unaudited)

(15) Asset to be disposed of by sale/asset impairment charge

A subsidiary of the Company owns a factory under construction in the PRC. In view of its production needs and the market conditions, the completion of the factory under construction was delayed. During the fourth quarter for the year ended March 31, 2001, management reassessed the fair value of the building given the downturn in the industrial property market in which the building is located and a provision of \$759 was recorded to adjust the carrying value of the building.

During the quarter ended June 30, 2002, the factory under construction and the related land use right in the PRC, which has an assigned period for 50 years commencing May 1993, were reclassified as asset to be disposed of by sale following management's decision to dispose of the property as a general purpose industrial building. As a result, the property has been written down to its fair market value less costs to sell pursuant to SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets, resulting in an asset impairment charge of \$13,378 during the year ended March 31, 2003. The net book value of the property and the land use right were \$4,071 and \$1,159 respectively as of September 30, 2004, March 31, 2004 and 2003. The Company entered into a contract for the sale of the subsidiary of the Company that holds title to this factory and the associated land use rights in the PRC. Management anticipates that the sale will be completed by year end.

(16) Concentration of Major Customers

One of our customers accounted for 11.1% of the Company's net sales during the six months ended September 30, 2004. No other customer accounted for more than 10% of the Company's net sales during this period.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

The following management's discussion and analysis of financial condition and results of operations is based upon and should be read together with the consolidated financial statements of the Company and notes thereto included in this Report and the Registrant's Annual Report on Form 10-K for the year ended March 31, 2004.

Forward-Looking Statements

Management's discussion and analysis of financial condition and results of operations and other sections of this Report contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We intend for the forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. These statements, which include statements regarding the Company's expected financial position, business and financing plans, our beliefs that our existing cash and cash equivalents and anticipated cash flow from operations will be sufficient to meet our anticipated cash needs in the ordinary course of business for at least the next 12 months, statements regarding possible shortages in PVC Resin and price increases in PVC Resin, our beliefs regarding foreign currency fluctuations and the potential impact of currency fluctuations on the Company, our expectation that we will be able to renegotiate the terms and conditions of our processing agreement, our beliefs that our operations in the PRC are now in compliance with the applicable PRC legal and regulatory requirements, statements regarding intellectual property rights of third parties, statements regarding the disposal of assets located in the PRC, statements regarding our critical accounting policies, and statements regarding the validity of lawsuits against the Company are forward-looking statements. Such forward-looking statements are identified by use of forward-looking words such as anticipates, believes, plans, estimates, expects, and intends or words or phrases of similar expression. These forward-looking statements are subject to various assumptions, risks and uncertainties, including but not limited to, changes in political and economic conditions in general and the unrest in the Middle East, the current war on terrorism and the impact of terrorist activities in the United States and abroad, economic conditions in the semiconductor and disk drive industries, any future economic downturn, demand for the Company's products, acceptance of new products, technology developments affecting the Company's products, the Company's ability to raise additional capital if necessary, the price and availability of raw materials, fluctuations in currency markets, the outcome of lawsuits by and against the Company, difficulties related to working in the PRC, including regional government and processing partner relations and contracts, foreign currency exchange laws, taxation and health issues, increased charges for under-absorbed production overhead costs, and those discussed in the Company's filings with the Securities and Exchange Commission. Actual results could differ materially from those contemplated by the forward-looking statements as a result of these factors and those set forth under Factors Which May Affect Operating Results below. These forward-looking statements speak only as of the date hereof. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company's expectations with regard hereto or any change in events, conditions or circumstances on which any such statement is based.

All references to the Company, Peak, we, us or our herein are references to Peak International Limited, a company incorporated under Bermuda law on January 3, 1997, and, unless the context otherwise requires, its subsidiaries and predecessors. All references to Peak (HK) herein are to Peak Plastic & Metal Products (International) Limited, a company incorporated in Hong Kong and a wholly-owned subsidiary of the Company and, unless the context otherwise requires, its subsidiaries and predecessors. References in this Quarterly Report on Form 10-Q (Quarterly Report) to our historical business and operations assume that the corporate reorganization in 1997 (the Restructuring) by which, among other things, Peak (HK) became a wholly-owned subsidiary of the Company and the Company acquired its other subsidiaries, had already occurred as of the times to which the references relate. Any discrepancies in the tables included in this Quarterly Report between the amounts indicated and the totals thereof are due to rounding. All references to US Dollars, US\$ or \$ herein are to United States dollars, references to HK Dollars or HK\$ are to Hong Kong dollars.

Results of Operations

Net Sales. Net sales increased by approximately 10.3% to \$16.8 million in the second quarter of fiscal 2005 from \$15.2 million in the same quarter of fiscal 2004. The increase was primarily due to an increase in sales of our semiconductor trays, tubes, tapes and reels. Net sales of semiconductor trays increased by 18.1% over the same period last year reflecting a 26.2% increase in sales volume, and a 6.4% drop in average realized sales prices. For the second quarter of fiscal 2005, net sales of tapes and reels increased by 25.9% compared to the second quarter of fiscal 2004, primarily due to a 51.3% increase in sales volume combined with a 16.8% drop in average realized sales prices. Net sales for tubes increased by 53.7% compared to the same period last year, primarily due to a 66.7% increase in sales volume for tubes and a decrease of 7.8% in the average realized sales price of tubes. Net sales for disk drive trays decreased by 46.6% compared to the same period last year, driven by a volume decrease of 6.5% and the drop in average realized sales prices by 42.9%. Our disk drive tray sales have generally been to one major customer or to subcontractors supporting that customer. These sales are largely dependent on the introduction of new products by that customer. New product introductions are difficult to forecast both with respect to timing as well as demand. We have been

producing new custom molds for that customer in anticipation of several new products, but this activity has not yet led to significant production orders. Mature products, while requiring some replacement trays, do not generally generate a sustainable high level of revenue. As a result, revenue from sales of our disk drive trays has, and will in the future, fluctuate dramatically with the corresponding fluctuations in the introduction of new products.

Net sales increased by approximately 14.2% to \$34.6 million for the six months ended September 30, 2004 from \$30.3 million for the six months ended September 30, 2003. Net sales of semiconductor trays increased by 29.4% comparing the six months ended September 30, 2004 to the six months ended September 30, 2003, primarily due to an increase in sales volume by 38.1% and a 6.4% drop in average realized sales prices. Net sales of tapes and reels increased by 27.4% comparing the six months ended September 30, 2004 to the six months ended September 30, 2003, primarily due to a 48.3% increase in sales volume and a 14.1% drop in average realized sales price. Net sales of tubes increased by 47.2% comparing the six months ended September 30, 2004 to the six months ended September 30, 2003, reflecting a 55.2% increase in sales volume and a 5.1% drop in average realized sales price. Net sales of disk drive trays decreased by 62.0% comparing the six months ended September 30, 2004 to the six months ended September 30, 2003, primarily due to a 45.4% decrease in sales volume combined with and a 30.3% drop in average realized sales price. Our disk drive tray sales have generally been to one major customer or to subcontractors supporting that customer. These sales are largely dependent on the introduction of new products by that customer. New product introductions are difficult to forecast both with respect to timing as well as demand. We have been producing new custom molds for that customer in anticipation of several new products, but this activity has not yet lead to significant production orders. Mature products, while requiring some replacement trays, do not generally generate a sustainable high level of revenue. As a result, revenue from sales of our disk drive trays has, and will in the future, fluctuate dramatically with the corresponding fluctuations in the introduction of new products.

Gross Profit. Gross profit decreased to \$2.8 million in the second quarter of fiscal 2005 from \$3.9 million in the second quarter of fiscal 2004. Gross margin decreased as a percentage of sales to 16.7% in the second quarter of fiscal 2005 from 25.3% in the same quarter of fiscal 2004. The decrease in gross profit and gross margin as a percent of sales were attributable to an increase in petroleum-based raw material costs as a consequence of the recent surge in crude oil prices, an increase of \$0.5 million in inventory reserves for SemiCycle trays, tubes, reels and tapes due to market price trends, as well as \$0.7 million of write offs of certain slow moving inventories and scrap materials.

Gross profit decreased to \$8.1 million for the six months ended September 30, 2004 from \$8.3 million for six months ended September 30, 2003. Gross margin as a percentage of sales dropped to 23.5% for the six months ended September 30, 2004 from 27.5% for the six months ended September 30, 2003. The decrease in gross profit and gross margin were primarily due to an increase in petroleum-based raw material costs as a consequence of the recent surge in crude oil prices, an increase of \$0.4 million in inventory reserve for SemiCycle trays, tubes, reels and tapes due to market price trends, as well as \$0.8 million of write offs of certain slow moving inventories and scrap materials.

Loss from Operations. An operating loss of \$1.9 million was recorded in the second quarter of fiscal 2005 compared to \$0.7 million in the second quarter of fiscal 2004. Operating loss margin increased from 4.6% to 11.6% when comparing the second quarter of fiscal 2005 to the second quarter of fiscal 2004. The increase in operating loss was due primarily to the decrease in gross margin.

An operating loss increased to \$1.5 million for the six months ended September 30, 2004 from \$0.6 million for the six months ended September 30, 2003. The increase in operating loss was primarily due to the decrease in gross margin.

Selling and Marketing. Selling and marketing expenses increased by 8.0% to \$3.0 million in the second quarter of fiscal 2005 from \$2.8 million in the second quarter of fiscal 2004, primarily due to an increase of \$0.2 million in freight charges and delivery expenses resulting from increased business volume.

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Selling and marketing expenses increased by 10.6% to \$6.2 million for the six months ended September 30, 2004 from \$5.6 million for the six months ended September 2003, primarily due to an increase of \$0.3 million in freight charges and delivery expenses resulting from increased business volume.

General and Administrative. General and administrative expenses remained steady at approximately \$1.7 million in the second quarter of fiscal 2005 and the second quarter of fiscal 2004.

General and administrative expenses increased by 4.7% to \$3.4 million for the six months ended September 30, 2004 from \$3.2 million for the six months ended September 30, 2003 primarily due to a refund in the amount of \$81,000 from our employer funded pension plan in the first quarter of fiscal 2004. The refund was a result of the return of our contributions to the pension plan for employees who had terminated their employment.

Other Income (Expense) net. Other Income (Expenses) net primarily represented differences in realized and unrealized exchange (losses) gains that we recorded arising from transactions in foreign currencies. During the second quarter of fiscal 2005, a net exchange loss of \$84,000 was recorded compared to a net exchange gain of \$63,000 that was recorded in the second quarter of fiscal 2004. The loss in the second quarter of fiscal 2005 was primarily due to unfavorable movements of New Taiwan Dollars, Singapore Dollars and Euro against the US Dollar.

For the six months ended September 30, 2004, a net exchange loss of \$164,000 was recorded compared to a net exchange gain of \$4,000 was recorded for the six months ended September 30, 2003. The loss in the six months ended September 30, 2004 was primarily due to unfavorable movements of New Taiwan Dollars and Singapore Dollars against the US Dollar.

Interest Income. Interest income increased by 15.8% to \$44,000 for the second quarter of fiscal 2005 from \$38,000 for the second quarter of fiscal 2004 primarily due to rising bank deposit interest rates in the second quarter of fiscal 2005.

Interest income decreased by 12.5% to \$77,000 for the six months ended September 30, 2004 from \$88,000 for the six months ended September 30, 2003, primarily due to the reduction in bank deposit interest rates and average cash balances in the first quarter of fiscal 2005.

Income Tax (Expense) Benefit. An income tax benefit of \$491,000 was recorded for the second quarter of fiscal 2005, compared to \$6,000 expenses recorded in the second quarter of fiscal year 2004. A net gain of \$340,000 was recognized as a result of a settlement with the IRD for prior years tax disputes.

A \$439,000 tax benefit was recorded for the six months ended September 2004, compared with the tax expense \$185,000 for the same period last year, primarily due to a net gain of \$340,000 that was recognized as a result of a settlement with the IRD for prior years tax disputes.

Net Loss. We had a net loss of approximately \$1.5 million for the second quarter of fiscal 2005, compared to a net loss of \$0.6 million for the same quarter of fiscal 2004, reflecting the effects of the previously discussed factors.

We had a net loss of \$1.2 million for the six months ended September, 2004, compared to a net loss of \$ 0.7 million for the six months ended September 30, 2003, as a result of the forgoing factors.

Loss Per Share. Diluted loss per share for the second quarter of fiscal 2005 was \$0.12, compared to a diluted loss per share of \$0.05 for the same period last year, reflecting the effects of the foregoing factors.

Diluted loss per share for the six months ended September 30, 2004 was \$0.09, compared to a diluted loss per share of \$0.06 for the same period last year, reflecting the effects of the foregoing factors.

Liquidity and Capital Resources

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Our net cash provided by operating activities was \$2.7 million for the six months ended September 30, 2004, which approximates the amount for the six months ended September 30, 2003. In the six months ended September 30, 2004, the tax dispute with the Inland Revenue Department of Hong Kong (HK IRD) has been settled, with tax reserve certificates and deposits previously paid to the HK IRD utilized on final settlement.

Net cash used in investing activities was \$3.0 million for the six months ended September 30, 2004, compared to \$3.1 million for the six months ended September 30, 2003. In the second quarter of fiscal 2005, \$3.9 million was paid for the acquisition of property, plant and equipment, while we spent \$3.1 million in the second quarter of fiscal 2004 on similar items.

Net cash provided by financing activities was \$0.3 million for the six months ended September 30, 2004, compared to net cash used in financing activities of \$1.9 million for the six months ended September 30, 2003. The decrease in net cash used in financing activities was primarily due to no repurchase of shares of our common stock during the second quarter of fiscal 2005 as compared to the second quarter of fiscal 2004 in which we repurchased \$2.4 million of our common stock.

As of September 2004, we had commitments for capital expenditures of \$0.3 million for the purchase of plant machinery and computer software and had no outstanding bank borrowings. Our cash and cash equivalents balance at September 30, 2004 was \$20.4 million. We believe that our existing cash and cash equivalents and anticipated cash flow from operations will be sufficient to meet our anticipated cash needs in the ordinary course of business for at least the next 12 months. If our existing

cash and cash equivalents and cash generated from operations is insufficient to satisfy our liquidity requirements, we may seek to sell additional public or private equity securities or obtain debt financing. There can be no assurance that additional funding will be available at all, or if available, will be obtained on terms favorable to us. Additional financing may also be dilutive to our existing shareholders.

Critical Accounting Policies

In preparing our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, we must make a variety of estimates that affect the reported amounts and related disclosures. The following accounting policies are currently considered most critical to the preparation of our financial statements. If actual results differ significantly from management's estimates and projections, there could be a material effect on our financial statements.

Revenue Recognition. Our revenue is recognized when the product has been shipped and title to the product has transferred to the customer. Title to the product may transfer to the end customer or distributor when shipped or when received by the customer based on a specific agreement. We evaluate the provision for estimated returns monthly, based on historical sales and returns. To date we have not experienced significant returns. Any increase in the level of returns could have a material and adverse effect on our financial statements.

Allowance for Doubtful Accounts. Allowance for doubtful accounts is made against accounts receivable to the extent they are considered to be doubtful. Accounts receivable in the balance sheet are stated net of such provision. We evaluate the collectability of our accounts receivable based on a combination of factors. In circumstances where we are aware of a specific customer's inability to meet its financial obligation to us, we record a specific reserve for bad debts against amounts due. A provision is also made based on the aging of the receivables. If circumstances change, such as the incurrence of higher than expected defaults or an unexpected material adverse change occurs regarding a major customer's ability to meet its financial obligations to us, our estimates of the recoverability of amounts due to us could be reduced by a material amount.

Inventory Valuation. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. At each balance sheet date, inventory on hand in excess of one year's demand or usage or those that were produced more than twelve months ago, are written down to zero. If actual future demand or market conditions are less favorable than those projected by management, additional write-downs may be required.

Valuation of Long-lived Assets. We assess the carrying value of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include the following:

significant under-performance relative to expected historical or projected future operating results;

significant changes in the manner of our use of the asset;

significant negative industry or economic trends; and

our market capitalization relative to net book value.

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Upon the existence of one or more of the above indicators of impairment, we test such assets for a potential impairment. The carrying value of a long-lived asset is considered impaired when the estimated future cash flows, undiscounted, are less than the asset's carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair market value of the long-lived asset. Fair market value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved.

Asset to be Disposed of by Sale. Asset to be disposed of by sale represents the factory under construction in Shenzhen, the PRC, together with the land use right on which the building is built and is stated at fair value less cost to sell as of the balance sheet date in accordance with SFAS No. 144 Accounting for the Impairment of Disposal or Long-Lived Assets. Fair value was calculated on the basis of a professional valuation report on the property provided by an independent appraiser.

Deferred Taxes. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes and tax bases of assets and liabilities in each of the jurisdictions in which we operate. This process involves us estimating our current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and, to the extent we believe that recovery is more unlikely than likely, we must establish a valuation allowance. To the extent we

establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the statement of operations. Any change in the future recoverability of the deferred tax assets could significantly affect the results of our operations or cash flows.

Property, plant and equipment, net Property, plant and equipment is stated at cost less accumulated depreciation. Gains or losses on disposals are reflected in current operations. Major expenditures for betterments and renewals are capitalized. All ordinary repairs and maintenance costs are expenses as incurred. Depreciation is provided using the straight-line method over the estimated useful lives.

The useful lives of property, plant and equipment adopted for depreciation purposes are as follows:

| | |
|--|------------|
| Buildings | 10 years |
| Plant, machinery and equipment | 5-10 years |
| Molds | 3-5 years |
| Leasehold improvements, furniture, fixtures and motor vehicles | 5-10 years |

Factors Which May Affect Operating Results

The risks and uncertainties described below are not the only ones we face. If an adverse outcome of any of the following risks actually occurs, our business, financial condition or results of operations could be materially and adversely affected. In evaluating our business, shareholders should consider carefully the following factors in addition to the other information presented herein.

Our operating results are difficult to predict and are likely to fluctuate significantly based on several factors, which can cause our stock price to decline.

Our operating results are affected by a wide variety of factors that could materially affect net sales and profitability or lead to significant fluctuations in our quarterly or annual operating results. These factors include, among others:

the price of raw materials, the majority of which are petroleum derivatives. Prices of these raw materials are significantly affected by oil prices which have become volatile recently;

factors relating to conditions in the semiconductor, disk drive and electronic industries including:

lower demand for products;

Increased price competition;

downturns and deterioration of business conditions;

technological changes; and

changes in production processes in the semiconductor and electronic industries which could require changes in packaging products;

capital requirements and the availability of funding;

our expansion plan and possible disruptions caused by the installation of new equipment or the construction of new facilities;

the lack of long-term purchase or supply agreements with customers;

the loss of key personnel or the shortage of available skilled employees;

our ability to complete the sale of our new plant that is substantially completed;

international political or economic events or developments, including those relating to Hong Kong and the PRC;

our relationship with our processing partner in the PRC;

production volume fluctuations and the management of our inventories;

currency fluctuations and foreign exchange rules and regulations in the PRC;

the recurrence of SARS or other major health issues in Asia;

the outcome of patent litigation in Taiwan; and

the imposition of fines, penalties and bonds arising from violations of rules and regulations in the PRC relating to customs regulations, foreign currency exchange rules, taxation, and other laws and regulations.

Unfavorable changes in the above or other factors could substantially harm our results of operations or financial condition. We believe that period to period comparisons of our results of operations will not necessarily be meaningful. You should not rely on these comparisons as an indication of our future performance. If our results of operations in one or more periods fail to meet or exceed the expectations of securities analysts or investors, the trading price of our common stock may decline, possibly by a significant amount.

We depend on the health of the semiconductor, disk drive and electronics industries which are highly cyclical and the decline in demand for products in these industries could severely affect our net sales and financial results.

Our net sales depend on increased demand for our products from manufacturers of semiconductor, disk drive and electronic components. Any deterioration of business conditions in the semiconductor industry, including lower demand for semiconductor products, decreased unit volume of semiconductor products shipped, other factors resulting in decreased demand for packaging products, or increased price competition in the semiconductor industry could result in increased price pressure on suppliers to the semiconductor industry, and could have a material adverse effect on our results of operations and financial condition. The industries we serve are characterized by rapid technological change leading to more complex products, evolving industry standards, intense competition and fluctuations in demand. From time to time, demand for electronic systems, which generally includes both semiconductors and electronic components, has suffered significant downturns, which in some cases have been prolonged. These downturns have been characterized by diminished product demand, product over-capacity and accelerated erosion of average selling prices. Any future downturn in the semiconductor or disk drive or electronics industries may substantially harm our results of operations or financial condition.

Our customer base is concentrated and the loss of one or more of our key customers would harm our business.

Our top 10 customers together accounted for 64.4%, 60.0% and 59.5% of our net sales in fiscal 2004, fiscal 2003 and fiscal 2002, respectively. We are dependent upon a single customer, Seagate Technology, for substantially all sales of our disk drive trays, with whom we have no long-term contract. In addition, for the six months ended September 30, 2004, ASE accounted for 11.1% of our net sales. Like Seagate Technology, we do not have a long-term contract with ASE. Our ability to maintain close, mutually beneficial relationships with our leading customers is important to the ongoing growth and profitability of our business. Although our sales to specific customers have varied from year to year, our results of operations have been dependent on a number of significant customers and the conditions of their respective industries. All of our customers operate in the global semiconductor, disk drive and electronic industries which historically have been highly cyclical. As a result of the concentration of our customer base, the loss or cancellation of business from, or significant changes in scheduled deliveries or decreases in the prices of products or services provided to, any of these customers could materially and adversely affect our results of operations and financial condition. Our sales are made pursuant to purchase orders, and therefore, we generally have no agreements with or commitments from our customers for the purchase of products. Although customers typically provide us with forecasts of their requirements, these forecasts are not binding. Our customers may not maintain or increase their sales volumes or orders for our products and we may be unable to maintain or add to our existing customer base.

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Our operations are concentrated in the People's Republic of China and we are subject to the risks associated with international operations, which could lead to increased costs and harm our business.

As of September 30, 2004, substantially all of our fixed assets and inventories were located in Shenzhen, the PRC. Our main production facilities are located in Shenzhen, the PRC and are operated pursuant to a processing agreement with an unaffiliated PRC company that obligates it to provide all of the personnel for the operation of our facilities and to render assistance in dealing with matters relating to the import of raw materials and the export of our products. We are dependent on continued good relations with our processing partner in order to supervise the operation of our factory and our employees. Our existing production facilities in Shenzhen, the PRC are located on land leased from the PRC government by one of our wholly-owned subsidiaries under land use certificates and agreements with a remaining term of approximately 38 years. Our assets and facilities located in the PRC and the PRC company's operation of these facilities are subject to the laws and regulations of the PRC and our results of operations in the PRC are subject to the economic and political situation in the PRC. While we expect to be able to renegotiate the terms and conditions of the processing agreement in the future to reflect some of the practices and procedures in effect at this time and to effect further changes, there are no assurances that we will be able to do so, which could lead to increased costs and harm our business.

The operations of our production facilities in Shenzhen, the PRC may be harmed by changes in the laws and regulations of the PRC or the interpretation thereof, such as those relating to taxation, import and export tariffs, environmental regulations, land use rights, property, foreign currency exchange regulations, and other matters. Prior to September 2002, we exported all the products manufactured at our production facilities in Shenzhen, the PRC. Accordingly, we were not subject to certain PRC taxes and were exempt from customs duties on imported raw materials and exported products. During the fourth quarter of fiscal 2003, we finished the procedure of setting up a wholly owned subsidiary in the PRC and now a small portion of our products are sold locally in the PRC. This newly established PRC subsidiary is subject to PRC taxes and custom duties on materials imported for PRC sales.

According to customs rules in the PRC, we may be subject to classification by the Chinese customs authorities in a manner that would require us to supply a substantial bond against customs duties that we would have to pay if we were importing material for ultimate sale in the PRC. We may also be subject to significantly higher administrative importation costs generally. These measures could harm our ability to manufacture products at a competitive price and our results of operations could suffer. In addition, if we are required to post a bond in connection with our exemption status from PRC duties on imported raw materials for export sales and exported products, we will experience a substantial drain of our liquid resources. We cannot assure that we will be able to provide the required bond at a commercially feasible cost, or at all.

We may become subject to PRC taxes and may be required to pay customs duties in the future even under the contract processing agreement. If we are required to pay PRC taxes or customs duties, our results of operations could suffer. We believe that our operations in Shenzhen, the PRC are now in compliance with the applicable PRC legal and regulatory requirements. However, we cannot assure that the central or local governments of the PRC will not impose new regulations or interpretations of existing laws, rules and regulations which could require additional expenditures or preclude the production of products in the PRC by Peak or our processing partner.

The economy of the PRC differs from the economies of many countries in many respects such as structure, government involvement, level of development, growth rate, capital reinvestment, allocation of resources, self-sufficiency, rate of inflation and balance of payments position, among others. In the past, the economy of the PRC has been primarily a planned economy subject to state plans. Since the entry of the PRC into the World Trade Organization in 2002, the PRC government has been reforming its economic and political systems. These reforms have resulted in significant economic growth and social change. We cannot assure, however, that the PRC government's policies for economic reforms will be consistent or effective. Our results of operations and financial position may be harmed by changes in the PRC's political, economic or social conditions.

We have in the past and may in the future, be parties to legal proceedings that could have a negative financial impact on us.

We have in the past been involved in litigation relating to securities and employment law, and are currently involved in litigation in Taiwan related to intellectual property and routine labor disputes in the PRC. While these lawsuits vary greatly in the materiality of potential liability associated with them, the uncertainty associated with substantial unresolved litigation could seriously harm our business, financial condition and reputation, whether material individually or in the aggregate. In particular, this uncertainty could harm our relationships with existing customers, our ability to obtain new customers and our ability to operate certain aspects of our business.

Litigation also could result in the diversion of our management's time and attention away from business operations, which could harm our business. Negative developments with respect to the litigation could cause the price of our common stock to decline significantly. In addition, we are unable to determine the amount, if any, that we may be required to pay if the litigation is not resolved in a favorable manner. For more information about the litigation, please see Item 1 entitled "Legal Proceedings" of Part II "Other Information."

A significant portion of our business is conducted in the Asia Pacific region. This concentration could expose us to risks inherent to doing business in the Asia Pacific region that could harm our business.

A significant portion of our net sales are derived from sales to customers in Hong Kong, Singapore, Taiwan, the Philippines and other countries in East and Southeast Asia, or the Asia Pacific region. Accordingly, our financial condition and results of operations and the market price of shares of our common stock may be affected by:

economic and political instability;

changes in regulatory requirements, tariffs, customs, duties and other trade barriers;

transportation delays;

fluctuations in currency exchange rates;

currency convertibility and repatriation;

taxation of our earnings and the earnings of our personnel;

the recurrence of SARS and other major health issues; and

other risks relating to changes, administration or new interpretations of laws, regulations and policies in the jurisdictions in which we conduct our business.

None of these factors are within our control. In fiscal 1999, many countries in the Asia Pacific region experienced considerable currency volatility and depreciation, high interest rates, stock market volatility and declining asset values which contributed to net foreign capital outflows, an increase in the number of insolvencies, a decline in business and consumer spending and a decrease in economic growth as compared with prior years.

Consumer demand for products that use semiconductors, disk drives and electronic components generally rises as the overall level of economic activity increases and falls as such activity decreases. In addition, currency devaluations in the Asia Pacific region could result in accelerated price erosion of semiconductor and electronic products as products manufactured in countries whose currencies have devalued significantly against the US dollar become less expensive in US dollar terms. Any adverse effect on the global semiconductor, disk drive and electronics industries as a result of lower demand for products in the Asia Pacific region or accelerated product price erosion arising from currency devaluations in the Asia Pacific region could harm our financial condition or results of operations.

We are incorporated under the laws of Bermuda and there may be potential difficulties in protecting our shareholders' rights.

We are incorporated under the laws of Bermuda and our corporate affairs are governed by our Memorandum of Association and Bye-laws and by the laws governing corporations incorporated in Bermuda. The rights of our shareholders and the responsibilities of members of our Board of Directors under Bermuda law are different from those applicable to a corporation incorporated in the United States and, therefore, our shareholders may have more difficulty protecting their interests in connection with actions by our management, members of our Board of Directors or our principal shareholder than they would as shareholders of a corporation incorporated in the United States.

Our stock price has been and will likely continue to be volatile and you may be unable to resell your shares at or above the price you paid.

Our stock price has been and is likely to continue to be highly volatile. Between July 1, 2004 and September 30, 2004, our stock price has traded as high as \$5.28 on September 30, 2004, and as low as \$4.12 on August 19, 2004. Our stock price could fluctuate significantly due to a number of factors, including:

variations in our actual or anticipated operating results;

sales of substantial amounts of our stock;

announcements about us or about our competitors, including technological innovation or new products or services;

litigation and other developments relating to patents or other proprietary rights or those of our competitors;

conditions in the semiconductor, disk drive and electronics industries;

governmental regulation and legislation;

international political or economic events or developments, including those relating to Hong Kong and the PRC;

the recurrence of SARS and other major health issues; and

changes in securities analysts' estimates of our performance, or our failure to meet analysts' expectations.

Many of these factors are beyond our control. In addition, the stock markets in general, and the NASDAQ National Market in particular, have experienced extreme price and volume fluctuations recently. These fluctuations often have been unrelated or disproportionate to the operating performance of these companies. These broad market and industry factors may decrease the market price of our common stock, regardless of our actual operating performance. In the past, companies that have experienced volatility in the market prices of their stock have been the object of securities class action litigation. If we were the object of securities class action litigation, it could result in substantial costs and a diversion of management's attention and resources, which could harm our business.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

PVC Compound Price

PVC compound, the principal material used in the manufacture of our tubes, together with additives, accounted for 7.8% and 7.9% of total raw material costs for the three months and six months ended September 30, 2004. While we believe, primarily as a result of increased production capacity by suppliers, that a severe shortage in the supply of PVC compound is unlikely to occur in the foreseeable future, there can be no assurance that such shortage will not occur. Any price increases would result in higher costs, which could have a material adverse effect on our results of operations and financial condition. We currently maintain approximately two to three months' stock of PVC compound and other raw materials used in our production processes, and increase such stock when we believe prices are favorable. We do not, and do not intend to, enter into future contracts or use any financial instruments to hedge our exposure to fluctuations in the price of PVC compound or other raw materials used in our production processes.

Currency Exchange Rate Fluctuations

Our sales are primarily denominated in US Dollars while our cost of goods sold are generally incurred in US Dollars, Hong Kong Dollars and Renminbi, and our operating expenses are generally denominated in Renminbi, Hong Kong Dollars, Singapore dollars, New Taiwanese dollars and US Dollars. In addition, a substantial portion of our capital expenditures, primarily for the purchase of equipment, has been and is expected to continue to be denominated in US Dollars, Renminbi, Japanese Yen and the Euro. Consequently, a portion of our costs and operating margins may be affected by fluctuations in exchange rates, primarily between the US Dollar and other currencies. Our results of operations and financial condition could be adversely affected by fluctuations in currency exchange rates or the imposition of new or additional currency controls in the jurisdictions in which we operate. At September 30, 2004, we had no outstanding foreign currency exchange contracts.

Many of our competitors are located in countries whose currencies devalued significantly against the US dollar beginning in the second half of 1997. As a result of such devaluation, these competitors' products have become less expensive in US dollar terms. This reduction could result in our customers purchasing products from these competitors rather than from us, which would have a material and adverse effect on our net sales and results of operations.

As the Hong Kong dollar is officially pegged to the US dollar and the Renminbi is controlled by the PRC government such that it only trades within a limited range against the US dollar, unless there are significant changes in the policies of the Hong Kong and the PRC government, fluctuations in the exchange rates of the Hong Kong dollar and the Renminbi are not expected to have a significant impact on our results of operations.

Item 4. Controls and Procedures

(a) *Evaluation of disclosure controls and procedures.* We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures

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are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that, subject to the limitations noted above, our disclosure controls and procedures were effective to ensure that material information relating to us, including our consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

(b) *Changes in internal control over financial reporting.* There was no significant change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with the evaluation described in Item 4(a) above that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1. *Legal Proceedings*

R.H. Murphy Co., Inc. (Murphy) is the owner of U.S. Reexamined Patent 5,400,904 C1 and certain corresponding foreign patents, which patents are directed to specific features in trays used to carry integrated circuits. Murphy has notified us and certain of our customers that it believes these patents are infringed by certain integrated circuit trays that we provided to our customers, and indicated that licenses to these patents are available. We do not believe that any valid claim of these patents is infringed, and are proceeding consistent with that belief.

On July 8, 2002, we placed a security bond of approximately \$301,000 at a Taiwanese district court in connection with a preliminary injunction order so that we can continue to sell trays in Taiwan without being interrupted by Murphy and its three distributors in Taiwan. The Taiwanese district court granted the preliminary injunction order in June 2002, after which Murphy's three local distributors filed an appeal with the Taiwanese high court against the grant of the order by the district court. In December 2002, the high court ruled that the anti-injunction order should be revoked. In February 2003, we filed an appeal to the Taiwanese Supreme Court which was granted and resulted in the dismissal of Murphy's local distributors' appeals. The grant of the preliminary injunction order has now become final and, accordingly, it is unlikely that Murphy or its local distributors will be able to obtain preliminary injunctive relief against us or our Taiwan customers during the pendency of the underlying litigation. In addition, in October 2002, we filed a civil suit against Murphy with the Taiwanese district court seeking permanent relief in connection with the preliminary injunction order. An additional security bond of approximately \$13,200 was placed with the Taiwanese court in connection with the underlying civil suit, which was later increased by approximately \$23,820. If our effort to receive permanent relief is not successful, we may be required to forfeit the bonds and Murphy and its distributors in Taiwan may assert patent infringement claims against us which, if successful, could prevent us from selling certain of our products in Taiwan and could result in monetary damages. In December 2001, we also filed an action with the Taiwanese Intellectual Property Office to invalidate Murphy's patent. In February 2002, we also filed a complaint for unfair competition with the Fair Trade Commission against Murphy. The Fair Trade Commission dismissed the action and we have filed an appeal. That appeal was dismissed and we filed an administrative suit contesting the dismissal. At present, the outcome of this patent dispute cannot be predicted with reasonable particularity and no impact to the financial statements has been reflected in this respect.

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

Not applicable.

Item 3. *Defaults Upon Senior Securities*

Not applicable.

Item 4. *Submission of Matters to a Vote of Security Holders*

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

- 3.1(a) Memorandum of Association and Bye-Laws of the Registrant (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form F-1, Registration No. 333-6652, filed on March 19, 1997 and declared effective by the Commission on June 20, 1997 (the Company's Initial Public Offering Registration Statement on Form F-1))
- 3.1(b) Bye-laws of the Registrant (incorporated by reference to Exhibit 3.1(b) of the Company's Annual Report on Form 10-K for the year ended March 31, 2001)
- 4.1 Specimen of Share Certificate for the Shares of the Registrant (incorporated by reference to Exhibit 4.1 to the Company's Amendment No. 1 to the Company's Initial Public Offering Registration Statement on Form F-1)
- 10.1 Employment Agreement, dated July 1, 2004, by and between the Registrant and Darien Spencer.
- 10.2 Employment Agreement, dated July 1, 2004, by and between the Registrant and Jack Menache.
- 10.3 Employment Agreement, dated July 1, 2004, by and between the Registrant and Danny Tong.
- 10.4 Employment Agreement, dated July 1, 2004, by and between the Registrant and Frank Lazo.
- 31.1 Rule 13a-14(a) Certification by the Chief Executive Officer
- 31.2 Rule 13a-14(a) Certification by the Chief Financial Officer
- 32.1* Section 1350 Certification by the Chief Executive Officer
- 32.2* Section 1350 Certification by the Chief Financial Officer

Indicates management contract or compensatory plan or arrangement.

- * In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release Nos. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibit 32.1 and Exhibit 32.2 are deemed to accompany this Form 10-Q and will not be deemed filed for purpose of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

EXHIBIT INDEX

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