

PEAK INTERNATIONAL LTD  
Form 10-Q  
August 15, 2005

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the Quarterly Period Ended June 30, 2005

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

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**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)

**38507 Cherry Street,**

**Unit G, Newark,**

**California**  
(Address of principal executive offices)

**None**  
(I.R.S. Employer

Identification Number)

**94560**  
(Zip Code)

**(510) 449-0100**

(Registrant's telephone number)

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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 August 5, 2005

<u>Class</u>	<u>Outstanding at August 5, 2005</u>
Common Stock, \$0.01 Par Value	12,420,388

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## 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 June 30,			
	2005		2004	
	(Unaudited)		(Unaudited)	
Net Sales	\$ 15,443	100.0%	\$ 17,794	100.0%
Cost of Goods Sold (Note 2)	16,079	104.1%	12,474	70.1%
Gross (Loss) Profit	(636)	(4.1)%	5,320	29.9%
Selling and Marketing (Note 3)	2,775	18.0%	3,148	17.7%
General and Administrative	1,759	11.4%	1,703	9.6%
Research and Development	44	0.3%	46	0.3%
(Loss) Income from operations	(5,214)	(33.8)%	423	2.4%
Other Income (expenses) net (Note 14)	2,055	13.3%	(80)	(0.4)%
Interest income, net	105	0.7%	33	0.2%
(Loss) Income before income taxes	(3,054)	(19.8)%	376	2.1%
Income tax benefit (expense) (Note 4)	442	2.9%	(52)	(0.3)%
Net (Loss) Income	\$ (2,612)	(16.9)%	\$ 324	1.8%
<b>(LOSS) EARNINGS PER SHARE (Note 8)</b>				
Basic	\$ (0.21)		\$ 0.03	
Diluted	\$ (0.21)		\$ 0.03	
Weighted Average Number of Shares Outstanding				
Basic	12,420,000		12,361,000	
Diluted	12,420,000		12,772,000	

(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)

	June 30, 2005	March 31, 2005
	(Unaudited)	
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 20,470	\$ 22,301
Restricted cash (Note 14)	1,282	
Accounts receivable net of allowance for doubtful accounts of \$270 at June 30, 2005 and \$257 at March 31, 2005	12,442	12,578
Inventories (Note 5)	12,761	13,739
Other receivables, deposits and prepayments	961	1,121
Income taxes receivable		3
	<u>          </u>	<u>          </u>
Total Current Assets	47,916	49,742
	<u>          </u>	<u>          </u>
Asset to be disposed of by sale (Note 14)		5,230
Property, Plant and Equipment net	24,121	24,611
Land Use Right	737	742
Deposits for Acquisition of Property, Plant and Equipment	48	33
Other deposit (Note 6)	301	301
	<u>          </u>	<u>          </u>
TOTAL ASSETS	\$ 73,123	\$ 80,659
	<u>          </u>	<u>          </u>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current Liabilities:		
Accounts payable:		
-trade	\$ 5,991	\$ 8,288
-property, plant and equipment	645	210
Accrued payroll and employee benefits	3,365	1,562
Accrued other expenses	1,503	5,786
Income taxes payable	98	127
	<u>          </u>	<u>          </u>
Total Current Liabilities	11,602	15,973
Deferred Income Taxes	404	875
	<u>          </u>	<u>          </u>
Total Liabilities	12,006	16,848
	<u>          </u>	<u>          </u>
Commitments and Contingencies (Note 12)		
Shareholders Equity:		
Common stock, \$0.01 par value; authorized 100,000,000 shares; issued and outstanding 12,420,388 shares at June 30, 2005, and 12,420,388 shares at March 31, 2005	124	124
Additional paid-in capital	27,135	27,135
Retained earnings	35,201	37,813
Accumulated other comprehensive loss	(1,343)	(1,261)
	<u>          </u>	<u>          </u>
Total shareholders equity	61,117	63,811
	<u>          </u>	<u>          </u>
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 73,123	\$ 80,659
	<u>          </u>	<u>          </u>

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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)

	Three Months Ended	
	June 30,	
	2005	2004
	(Unaudited)	(Unaudited)
Operating activities:		
Net (loss) income	\$ (2,612)	\$ 324
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,609	1,679
Deferred income taxes	(471)	50
Loss on disposal/write-off of property, plant and equipment	139	29
Allowance for doubtful accounts	13	(4)
Gain on disposal of a subsidiary	(2,189)	
Changes in operating assets and liabilities:		
Accounts receivable	123	(424)
Inventories	978	(235)
Other receivables, deposits and prepayments	(113)	(382)
Income taxes receivable	3	(144)
Accounts payable-trade	(2,297)	938
Accrued payroll, employee benefits and other expenses	1,676	4
Income taxes payable	(29)	2
Net cash (used in) provided by operating activities	(3,170)	1,837
Investing activities:		
Net proceeds on disposal of a subsidiary	2,254	
Acquisition of property, plant and equipment	(818)	(3,253)
(Increase) decrease in deposits for acquisition of property, plant and equipment	(15)	954
Net cash provided by (used in) investing activities	1,421	(2,299)
Financing activities:		
Proceeds from issuance of common stock		288
Net cash provided by financing activities		288
Net decrease in cash and cash equivalents	(1,749)	(174)
Cash and cash equivalents at beginning of period	22,301	20,303
Effects of exchange rate changes on cash and cash equivalents	(82)	27
Cash and cash equivalents at end of period	\$ 20,470	\$ 20,156
Supplemental cash flow information:		
Cash paid during the period		
Income taxes	\$ 54	\$ 144

(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, reels and carrier tapes, leadframe boxes and interleaves used in the storage and transportation of semiconductor devices and other electronic components. In March 2005, the Company exited the production and sale of shipping tubes. 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, 2005.

**New Accounting Standards**

In May 2005, the FASB issued FASB Statement No. 154, *Accounting Changes and Error Corrections*, which requires entities that voluntarily make a change in accounting principle to apply that change retrospectively to prior periods' financial statements, unless this would be impracticable. SFAS No. 154 supersedes APB Opinion No. 20, *Accounting Changes*, which previously required that most voluntary changes in accounting principle be recognized by including in the current period's net income the cumulative effect of changing to the new accounting principle. SFAS No. 154 also makes a distinction between retrospective application of an accounting principle and the restatement of financial statements to reflect the correction of an error. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 which would be fiscal 2007, beginning April 1, 2006 for the Company. The adoption of SFAS No. 154 is not expected to have a material effect on the Company's consolidated financial position or results of operations.



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In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107. SAB 107 provides guidance related to share-based payment transactions with non-employees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of Statement 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of Statement 123R, the modification of employee share options prior to adoption of Statement 123R and disclosures in Management's Discussion and Analysis ( MD&A ) subsequent to adoption of Statement 123R. The Company is currently in the process of assessing the impact of this guidance.

In December, 2004, the FASB issued FASB Statement No. 123 (revised 2004), Share-Based Payment, or Statement 123(R), which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation . Statement 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. or Opinion 25. Generally, the approach in Statement 123(R) is similar to the approach described in the unrevised Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. In April 2005, the SEC deferred the effective date of Statement 123(R) so that companies may now adopt its provisions at the beginning of their first annual period beginning after June 15, 2005 which would be fiscal 2007, beginning April 1, 2006 for the Company. As permitted by the unrevised Statement 123, the Company

**Notes to Condensed Consolidated Financial Statements (continued)**

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

currently accounts for share-based payments to employees using Opinion 25's intrinsic value method, under which the Company generally does not record compensation cost for employee stock options. Accordingly, the adoption of Statement 123(R)'s fair value method will have a significant impact on the Company's results of operations, although it will have no impact on the Company's overall financial position. The impact of adoption of Statement 123(R) cannot be predicted at this time because it will depend, in part, on levels of share-based payments granted in the future. However, had the Company adopted Statement 123(R) in prior periods, the impact of that standard would have approximated the impact of Statement 123 as described in the disclosure of pro forma net (loss) income and (losses) earnings per share in Note 10 to our Condensed Consolidated Financial Statements.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29. SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005, which would be our second quarter of fiscal 2006. The adoption of SFAS No. 153 is not expected to have a material effect on our consolidated financial position or results of operations.

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 151, Inventory Costs - An Amendment of ARB No. 43, Chapter 4, which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005, which would be the Company's second quarter of fiscal 2006 and its adoption is not expected to have a significant impact on our results of operations or financial position.

**(2) Cost of goods sold**

Included therein was \$102 (unaudited) (2004-\$58, unaudited) write-off of machinery and molds due to technological obsolescence for the three months ended June 30, 2005. Also included was an inventory reserve of \$360 for recycled materials that could not be economically utilized and \$207 of scrap materials write-off. There was severance payment of approximately \$79 paid to workers at the factory whose jobs were outsourced and approximately \$62 incurred in connection with the consolidation of the Company's offices in Malaysia.

In April 2005, the PRC tax authorities began an investigation into the withholding and payment of income taxes by the factory in Shenzhen ( Factory ) that is operated pursuant to a processing agreement with an unaffiliated party, for certain current and former employees of the Company, its affiliates or other companies who performed services at the Factory but may not have paid income taxes in the PRC and for whom the Factory may not have withheld and paid income taxes. The PRC tax authorities will likely seek to collect unpaid income taxes on salaries and expense allowances of certain current and former employees of the Company, its affiliates or other companies who performed services in the PRC based on the worker's relationship with the Factory and interest and penalties on such amounts. Since some of these claims are based on income earned over several years, the amount of such taxes, accrued interest and penalties could be substantial. The Company does not believe that it is liable for such claims, but in the event the PRC tax authorities determine payments for back taxes, interest and penalties are owed, the potential consequences include substantial monetary claims against the Factory or the seizure of the Factory and the Company's assets at the Factory and the termination of substantially all of the Company's production operations. In the event the PRC authorities asserted claims for such taxes against the Factory, the Company may make such payments on a voluntary basis in order to avoid the seizure of the Factory or the Company's assets at the Factory and to keep it operational. The Company engaged advisors to assist the Company in assessing the Factory's and the Company's obligations with respect to the withholding and payment of income taxes by the Factory. Upon completion of this assessment, the advisors concluded that amount of unpaid income taxes and interest for certain former employees stationed at or employed by the Factory that could be estimated with a reasonable basis, was \$1,703. At this point, the Company does not believe the Factory has sufficient assets to pay such amounts. As a result, the Company anticipates it may have to pay such amount and has accrued \$1,703 as additional manufacturing costs for the

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quarter ended June 30, 2005. Penalties on the above unpaid income taxes and liability for income taxes, interest and penalties for certain other individuals associated with the Factory could not be reasonably estimated. Accordingly, the Company has not accrued for these in the quarter ended June 30, 2005. See note 12(b) Contingencies.

**Notes to Condensed Consolidated Financial Statements (continued)**

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

**(3) Delivery and freight expenses**

For the three months ended June 30, 2005, the Company incurred delivery and freight expenses of approximately \$811 (unaudited) (2004 \$894, unaudited), which have been included as part of selling and marketing expenses.

**(4) Income Tax Benefit (Expense)**

Income is subject to taxation in the various countries in which the Company and its subsidiaries operate.

## Notes to Condensed Consolidated Financial Statements (continued)

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

## (5) Inventories

	June 30, 2005	March 31, 2005
	(Unaudited)	
Raw materials	\$ 6,818	\$ 8,394
Finished goods	5,943	5,345
	<u>\$ 12,761</u>	<u>\$ 13,739</u>

## (6) 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 12(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.

## (7) 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, 2005	2,362,679	\$ 5.48
Granted	216,000	3.41
Exercised		
Forfeited	(30,798)	4.98
Outstanding at June 30, 2005	<u>2,547,881</u>	<u>5.36</u>

Outstanding Options

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	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

## Notes to Condensed Consolidated Financial Statements (continued)

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

**(8) (Loss) Earnings Per Share**

The following is a reconciliation of the numerator and the denominator of the basic (losses) earnings per share:

	Three Months Ended	
	June 30,	
	2005	2004
	(Unaudited)	(Unaudited)
<b>Numerator:</b>		
Net (loss) income	\$ (2,612)	\$ 324
<b>Denominator:</b>		
Weighted average number of shares outstanding		
Basic	12,420,388	12,360,683
Assumed exercise of stock options		410,905
<b>Diluted</b>	<b>12,420,388</b>	<b>12,771,588</b>

For the three months ended June 30, 2005, 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.

**(9) Comprehensive (Loss) Income**

The Company's comprehensive (loss) income consists of the following:

	Three Months Ended	
	June 30,	
	2005	2004
	(Unaudited)	(Unaudited)
Net (loss) income	\$ (2,612)	\$ 324
Other comprehensive (loss) income:		
Foreign currency translation	(82)	27

Comprehensive (loss) income	\$ (2,694)	\$ 351
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**(10) Employee Stock Purchase and Option Plans**

During the three months ended June 30, 2005, the Company issued options for 216,000 shares to officers and employees of the Company under the 1998 Stock Option Plan at an exercise price of \$ 3.41 per share . The Company did not issue any options under the 1997 Stock Option Plan nor issue any shares under the 2000 Employee Stock Purchase Plan during the three months ended June 30, 2005,

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.



## Notes to Condensed Consolidated Financial Statements (continued)

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

No stock-based employee compensation cost is reflected in net (loss) income, 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.

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) income and (loss) earnings per share would have been increased/decreased as follows:

	Three months ended	
	June 30,	
	2005	2004
	(Unaudited)	(Unaudited)
Net (loss) income, as reported	\$ (2,612)	\$ 324
Add: compensation expense (recognized) released under SFAS no. 123, net of tax	\$ (133)	\$ 23
Pro forma net (loss) income	\$ (2,745)	\$ 347
Pro forma (loss) earnings per share		
- Basic	\$ (0.22)	\$ 0.03
- Diluted	\$ (0.22)	\$ 0.03

**(11) 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.

There was no repurchase of shares for the three months ended June 30, 2005 and 2004.

**(12) 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

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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

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**Notes to Condensed Consolidated Financial Statements (continued)**

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

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, 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 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 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 \$23. 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 and the Company 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.

**(b) Contingencies**

In April 2005, the PRC tax authorities began an investigation into the withholding and payment of income taxes by the Factory in Shenzhen for certain current and former employees of the Company, its affiliates or other companies who performed services at the factory but may not have paid income taxes in the PRC and for whom the Factory may not have withheld and paid income taxes. The PRC tax authorities will likely seek to collect unpaid income taxes on salaries and expense allowances of certain current and former employees of the Company, its affiliates or other companies who performed services in the PRC based on the worker's relationship with the Factory and interest and penalties on such amounts. Since some of these claims are based on income earned over several years, the amount of such taxes, accrued interest and penalties could be substantial. The Company does not believe that it is liable for such claims, but in the event the PRC tax authorities determine payments for back taxes, interest and penalties are owed, the potential consequences include substantial monetary claims against the Factory or the seizure of the Factory and the Company's assets at the Factory and the termination of substantially all of our production operations. In the event the PRC authorities asserted claims for such taxes against the Factory, the Company may make such payments on a voluntary basis in order to avoid the seizure of the Factory or the Company's assets at the Factory and to keep it operational. The Company engaged advisors to assist the Company in assessing the Factory's and the Company's obligations with respect to the withholding and payment of income taxes by the Factory. Upon completion of this assessment, the advisors concluded that amount of unpaid income taxes and interest for certain former employees stationed at or employed by the Factory that could be estimated with a reasonable basis, was \$1,703. At this point, the Company does not believe the Factory has sufficient assets to pay such amounts. As a result, the Company anticipates it may have to pay such amount and has accrued for tax payable and interest thereon amounting to \$1,703 as additional manufacturing costs for the three months ended June 30, 2005. At present, the potential penalty for the unpaid income tax and interest, as well as the amount of tax payable and interest thereon for some other current and former employees of the Company, its affiliates or other companies, cannot be estimated with reasonable particularity and therefore no impact to the financial statements has been reflected in these respects.

**(c) Commitments**

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At June 30, 2005, the Company had commitments for capital expenditures of approximately \$294.

**(13) Segment Information**

	<b>Hong Kong &amp; the PRC</b>	<b>United States</b>	<b>Other Asian countries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Quarter ended June 30, 2005 (unaudited)</b>					
Net sales to third parties	\$ 7,587	\$ 1,024	\$ 6,832	\$	\$ 15,443
Transfer between geographic areas	7,127		1,099	(8,226)	
<b>Total net sales</b>	<b>\$ 14,714</b>	<b>\$ 1,024</b>	<b>\$ 7,931</b>	<b>\$ (8,226)</b>	<b>\$ 15,443</b>
<b>(Loss) Income before tax</b>	<b>\$ (3,164)</b>	<b>\$ 109</b>	<b>\$ (164)</b>	<b>\$ 165</b>	<b>\$ (3,054)</b>
<b>Quarter ended June 30, 2004 (unaudited)</b>					
Net sales to third parties	\$ 8,920	\$ 1,134	\$ 7,740	\$	\$ 17,794
Transfer between geographic areas	8,263		724	(8,987)	
<b>Total net sales</b>	<b>\$ 17,183</b>	<b>\$ 1,134</b>	<b>\$ 8,464</b>	<b>\$ (8,987)</b>	<b>\$ 17,794</b>
<b>Income (Loss) before tax</b>	<b>\$ 513</b>	<b>\$ 37</b>	<b>\$ (160)</b>	<b>\$ (14)</b>	<b>\$ 376</b>

**Notes to Condensed Consolidated Financial Statements (continued)**

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

**(14) Restricted cash/Asset to be disposed of by sale/Other income**

A former subsidiary of the Company owned an industrial building under construction in the PRC. In view of its production needs and the market conditions, the completion of the building under construction was delayed. During the fourth quarter of 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 industrial building 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 of 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 March 31, 2005, 2004 and 2003.

The Company entered into a contract with an independent third party for the sale of the subsidiary of the Company that held title to this building and the associated land use rights in the PRC. The sale was completed on April 13, 2005 for approximately \$7,692 in cash. About \$1,282 of the sale proceeds is held in escrow as restricted cash to fund contingencies and will not be available for use by the Company in the next two years. At present, management is unaware of any contingency that will result in the forfeiture of either the full or part of the amount. A net gain on disposal of approximately \$2,189 was recognized in the current quarter.

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**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, 2005.

*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 belief that it is not contractually obligated to pay amounts owed by the Company or the factory at which the Company's products are manufactured and its expectations regarding the assessment of any penalties on such amounts, 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, 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 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, the outcome of any investigations by the PRC authorities, amounts the Company may have to pay for back taxes, interest and penalties to the PRC tax authorities, the Company's ability to continue to be listed on the Nasdaq Stock Market, 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 Berm 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 decreased by approximately 13.2% to \$15.4 million in the first quarter of fiscal 2006 from \$17.8 million in the same quarter of fiscal 2005. The decrease was primarily due to a decrease in sales of our semiconductor trays, tubes, tapes and reels. Net sales of semiconductor trays decreased by 16.2% over the same period last year reflecting a 18.3% decrease in sales volume, and a 2.6% increase in average selling price. For the first quarter of fiscal 2006, net sales of tapes and reels decreased by 8.3% compared to the first quarter of fiscal 2005, primarily due to a 7.8% decrease in sales volume combined with a 0.5% drop in average selling price. Net sales for tubes decreased by 98.0% compared to the same period last year as a result of our decision to exit the production and sale of shipping tubes in March 2005. Net sales for disk drive trays increased by 194.1% compared to the same period last year, driven by a volume increase of 142.0% and an increase in average selling price by 21.5% because of sales mix. 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 produced new custom molds for that customer, which led to an increase in production orders in the first quarter of fiscal 2006 as compared to the first quarter of fiscal 2005. 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 (Loss) Profit.* Gross loss was \$0.6 million in the first quarter of fiscal 2006 as compared to a gross profit of \$5.3 million in the first quarter of fiscal 2005. Gross margin decreased as a percentage of sales to (4.1)% in the first quarter of fiscal 2006 from 29.9% in the same quarter of fiscal 2005. There were additional materials used of approximately \$0.6 million primarily due to product mix and more prime materials used during the quarter ended June 30, 2005. The gross profit in the first quarter of fiscal 2006 also included an inventory reserve of \$0.4 million for recycled materials that could not be economically utilized and \$0.2 million of scrap materials write-off. There was severance payment of approximately \$80,000 paid to workers at the factory whose jobs were outsourced and approximately \$60,000 was incurred in connection with the consolidation of our offices in Malaysia.

In April 2005, the PRC tax authorities began an investigation into the withholding and payment of income taxes by the factory in Shenzhen ( Factory ) that is operated pursuant to a processing agreement with an unaffiliated party, for certain current and former employees of Peak, its affiliates or other companies who performed services at the Factory but may not have paid income taxes in the PRC and for whom the Factory may not have withheld and paid income taxes. The PRC tax authorities will likely seek to collect unpaid income taxes on salaries and expense allowances of certain current and former employees of Peak, its affiliates or other companies who performed services in the PRC based on the worker's relationship with the Factory and interest and penalties on such amounts. Since some of these claims are based on income earned over several years, the amount of such taxes, accrued interest and penalties could be substantial. We do not believe that we are liable for such claims, but in the event the PRC tax authorities determine payments for back taxes, interest and penalties are owed, the potential consequences include substantial monetary claims against the Factory or the seizure of the Factory and our assets at the Factory and the termination of substantially all of our production operations. In the event the PRC authorities asserted claims for such taxes against the Factory, we may make such payments on a voluntary basis in order to avoid the seizure of the Factory or our assets at the Factory and to keep it operational. We engaged advisors to assist us in assessing the Factory's and our obligations with respect to the withholding and payment of income taxes by the Factory. Upon completion of this assessment, the advisors concluded that amount of unpaid income taxes and interest for certain former employees stationed at or employed by the Factory that could be estimated with a reasonable basis, is \$1.7 million. At this point, we do not believe the Factory has sufficient assets to pay such amounts. As a result, we anticipate we may have to pay such amount and we have accrued \$1.7 million as additional manufacturing costs for the quarter ended June 30, 2005. Penalties on the above unpaid income taxes and liability for income taxes, interest and penalties for certain other individuals associated with the Factory could not be reasonably estimated. Accordingly, we have not accrued for those in the quarter ended June 30, 2005.

*(Loss) Income from Operations.* An operating loss of \$5.2 million was recorded in the first quarter of fiscal 2006 compared to an operating income of \$0.4 million in the first quarter of fiscal 2005. Operating margin changed from an income of 2.4% to a loss of 33.8% when comparing the first quarter of fiscal 2006 to the first quarter of fiscal 2005. The change from operating income to operating loss was primarily due to the decrease in gross margin.

*Selling and Marketing.* Selling and marketing expenses decreased by 11.8% to \$2.8 million in the first quarter of fiscal 2006 from \$3.1 million in the first quarter of fiscal 2005, primarily due to decrease in freight charges and delivery expenses resulting from decreased sales volume and cost savings from consolidation of offices.

*General and Administrative.* General and administrative expenses increased slightly by 3.3% to \$1.8 million in the first quarter of fiscal 2006 from \$1.7 million in the first quarter of fiscal 2005.

*Other Income (Expenses) net.* Other Income (Expenses) net primarily represented gain on disposal of a subsidiary. During the first quarter of fiscal 2006, we completed the disposal of one of our subsidiaries to an independent third party. The disposed subsidiary holds title to an incomplete factory in the PRC. The sale was completed on April 13, 2005 for approximately of \$7.7 million in cash.

*Interest Income.* Interest income increased to \$105,000 for the first quarter of fiscal 2006 from \$33,000 for the first quarter of fiscal 2005 primarily due to increase in bank deposit interest rates.



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*Income Tax Benefit (Expense)* . An income tax benefit of \$442,000 was recorded for the first quarter of fiscal 2006 mainly because of our operating loss for the quarter, compared to an income tax expense of \$52,000 recorded in the first quarter of fiscal year 2005 arising from operating income for the quarter.

*Net (Loss) Income*. We had a net loss of approximately \$2.6 million for the first quarter of fiscal 2006, compared to a net income of \$0.3 million for the same quarter of fiscal 2005, reflecting the effects of the previously discussed factors.

*(Losses) Earnings Per Share.* Diluted losses per share for the first quarter of fiscal 2006 was \$0.21, compared to a diluted earnings per share of \$0.03 for the same period last year, reflecting the effects of the foregoing factors.

#### *Liquidity and Capital Resources*

Our net cash used in operating activities was \$3.2 million for the three months ended June 30, 2005, compared to net cash provided by operating activities of \$1.8 million for the three months ended June 30, 2004. This was primarily due to a decrease in operating profit.

Net cash provided by investing activities was \$1.4 million for the three months ended June 30, 2005, compared to net cash used in investing activities of \$2.3 million for the three months ended June 30, 2004. This was primarily due to proceeds received on disposal of a subsidiary that occurred in the first quarter of fiscal 2006 and a reduction in the acquisition of plant and equipment during the three months ended June 30, 2005 as compared to the three months ended June 30, 2004.

No net cash was provided by nor used in financing activities for the three months ended June 30, 2005 as there was no issuance or repurchase of common stock, compared to net cash provided by financing activities of \$0.3 million for the three months ended June 30, 2004 arising from issuance of common stock.

As of June 30, 2005, we had commitments for capital expenditures of \$0.3 million and had no outstanding bank borrowings. Our cash and cash equivalents balance at June 30, 2005 was \$20.5 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 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

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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.

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 of 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 that 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 recently have become volatile;

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;

although we do not believe that it is our liability, the need for us to pay and the amounts that we might pay on a voluntary basis for certain tax, social insurance contributions and potential penalties on behalf of the Factory at which our products are manufactured in order to avoid the seizure of the Factory's assets and keep it operational, as well as claims resulting from employee lawsuits against the Factory;

capital requirements and the availability of funding;

difficulties in recycling trays manufactured using our proprietary plastic compounds;

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

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

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 and the ability of the government of the PRC to seize the assets and shut down our factory operated 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, the withholding of taxes for employees and other laws and regulation.

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 include both semiconductors and electronic components, has suffered significant downturns, which in some cases have been prolonged. For example, during 2002 and 2003, demand for our products decreased as the overall economy and the electronics industry experienced a general downturn in business. 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 67.8%, 64.4% and 60.0% of our net sales in fiscal 2005, fiscal 2004 and fiscal 2003, 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 three months ended June 30, 2005, ASE and Stats/Chippac accounted for 10.7% and 10.4% respectively of our net sales. Like Seagate Technology, we do not have a long-term contract with ASE or StatsChippac. 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.

**Our operations are concentrated in the People's Republic of China and we are subject to the risks associated with international operations, which may negatively affect our business.**

As of June 30, 2005, 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 (the "Factory") 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 the factory and its 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 37 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. In January 2005, we entered into negotiations with our processing partner to revise and update our agreement regarding the operation of the Factory. While these negotiations have been suspended, we expect to be able to renegotiate some of the terms and conditions of the processing agreement. There are no assurances that we will be able to do so, which could lead to increased costs and harm our business. In addition, during the third fiscal quarter of 2005, we discovered discrepancies, which were at the our main production facilities in Shenzhen and not at Peak, in the computation and withholding of both taxes and social insurance contributions for workers at the Factory. Upon discovery of these discrepancies, we conducted an internal review of the Factory's practices and we concluded that the Factory had a duty to correct certain of these discrepancies. We may in the future need to make additional payments on a voluntary basis in order to avoid the seizure of the Factory or our assets at the Factory and to keep it operational. Voluntary payments by us on behalf of the Factory to the PRC tax authorities could diminish a significant portion of our current cash reserves and materially harm our operating results and 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 are 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 hence a small portion of our products was sold locally in the PRC. This PRC subsidiary is subject to PRC taxes and customs duties on materials imported for such PRC sales. This PRC subsidiary has ceased manufacturing operations.

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



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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 may not 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 for custom duties. However, the central or local governments of the PRC may 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, and the factory at which our products are manufactured, have in the past and may in the future be the subject of investigations by PRC government authorities, which can divert management's attention, lead to fines and penalties, increase our costs and harm our operating results.**

We and the Factory have in the past and may in the future be the subject of investigations by PRC government authorities. Such investigations are expensive and time-consuming and could divert management's attention away from running our business. In addition, as a result of such investigations we or the Factory may be subject to taxes, fines or penalties, which would increase our costs and harm our operating results. In the event the Factory is unable to pay any fines or penalties assessed against it by PRC authorities, we may voluntarily pay such amounts to avoid the seizure of our assets and the closure of the Factory. For example, in April 2005, the PRC tax authorities began an investigation of the Factory and into the withholding and payment of income taxes by the Factory in Shenzhen for certain current and former employees of Peak, its affiliates or other companies who performed services at the Factory but may not have paid income taxes in the PRC and for whom the Factory may not have withheld and paid income taxes. The PRC tax authorities will likely seek to collect unpaid income taxes on salaries and expense allowances of certain current and former employees of Peak, its affiliates or other companies who performed services in the PRC based on the worker's relationship with the Factory and interest and penalties on such amounts. Since some of these claims are based on income earned over several years, the amount of such taxes, accrued interest and penalties could be substantial. In the event the PRC tax authorities determine payments for back taxes, interest and penalties are owed, the potential consequences include substantial monetary claims against the Factory or the seizure of the Factory and our assets at the Factory and the termination of substantially all of our production operations. In the event the PRC authorities asserted claims for such taxes against the Factory, we may make such payments on a voluntary basis in order to avoid the seizure of the Factory or our assets at the Factory and to keep it operational. Voluntary payments by us on behalf of the Factory to the PRC tax authorities could diminish a significant portion of our current cash reserves and materially harm our operating results and business. In addition, the Factory and the Company may in the future be subject to further investigations by the PRC authorities, including tax authorities, for similar or other claims, including claims for other unpaid taxes, which we may be required to pay in order to avoid seizure of the Shenzhen Factory or some or all of its or our assets.

**We have in the past and may in the future, be party 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, tax and labor disputes in the PRC. While these lawsuits and disputes 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 our business.

Litigation and the resolution of disputes 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 litigation is not resolved in a favorable manner. For more information about the litigation, please see Part II, Item 1 entitled "Legal Proceedings."

**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;

amounts we may have to pay in the PRC on behalf of the Factory in Shenzhen for past personal income taxes, interest and penalties that may be imposed by PRC tax authorities on the income of foreign workers who performed services in the Shenzhen Factory;

amounts we may have to pay on behalf of the factory in the PRC as a result of employees' litigation against the factory in Shenzhen; 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 electronic 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

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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. A decline in our stock price could result in securities class action litigation against us, which could divert management's attention and harm our business.**

Our stock price has been and is likely to continue to be highly volatile. Between April 1, 2005 and June 30, 2005, our stock price has traded as high as \$3.89 on June 30, 2005, and as low as \$3.06 on May 3 and May 26, 2005. 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;

the outcome of current investigations by PRC authorities, amounts we may have to pay in the PRC for past personal income taxes, interest and penalties that may be imposed by PRC tax authorities on the income of foreign workers who performed services in the Shenzhen Factory and the outcome of any future investigation by PRC authorities;

amounts we may have to pay on behalf of the factory in the PRC as a result of employees' litigation against the Factory; 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 other securities class action litigation, it could result in substantial costs and a diversion of management's attention and resources, which could harm our business.

**If we fail to maintain an effective system of internal controls, we may not be able to accurately or timely report our financial results or prevent fraud. As a result, current and potential shareholders could lose confidence in our financial reporting, which would harm our business and the trading price of our stock.**

Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. If we cannot provide reliable financial reports or prevent fraud, our operating results could be harmed. We have in the past discovered, and may in the future discover, areas of our internal controls that need improvement and we have devoted, and will in the future devote, resources to remediate and improve our internal controls. Although we believe that these efforts have strengthened our internal controls, we are continuing to work to improve our internal controls. We cannot be certain that these measures will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. Any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our common stock.

**Changes to financial accounting standards may affect our results of operations and cause us to change our business practices.**

We prepare our financial statements to conform with generally accepted accounting principles, or GAAP, in the United States. These accounting principles are subject to interpretation by the American Institute of Certified Public Accountants, the Securities and Exchange Commission and various bodies formed to interpret and create appropriate accounting policies. A change in those policies can have a significant effect on our reported results and may affect our reporting of transactions completed before a change is announced. Changes to those rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business. For example, accounting policies affecting many aspects of our business, including rules relating to employee stock option grants, have recently been revised or are under review. The Financial Accounting Standards Board and other agencies have finalized changes to U.S. generally accepted accounting principles that will require us, starting in our fiscal year 2007, to record a charge to earnings for employee stock option grants and other equity incentives. We may

have significant and ongoing accounting charges resulting from option grant and other equity incentive expensing that could reduce our overall net income. In addition, since we historically have used equity-related compensation as a component of our total employee compensation program, the accounting change could make the use of equity-related compensation less attractive to us and therefore make it more difficult to attract and retain employees.

**Item 3. *Quantitative and Qualitative Disclosures about Market Risk***

*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 June 30, 2005 and 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 are met. Our disclosure controls and procedures have been designed to meet reasonable assurance standards. 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, 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 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 management's evaluation during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

As a result of a review of the Factory's controls and procedures, management noted additional areas for improvement in the Factory's internal controls. Although we have no responsibility for the Factory, management, with the oversight of the Audit Committee, has been addressing these issues at the Factory and is committed to effectively improve the internal controls at the Factory as expeditiously as possible. To address these issues:



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we are reviewing and updating the current Bills of Materials and standard costs for our finished goods;

the Factory is in the process of instituting revised and more formulated procedures as well as additional required approvals for:

the review of and changes to the Bills of Materials of finished goods;

the use of materials from production;

the release of finished goods from the Factory's warehouses;

the write-off of scrap material; and

the handling and processing of goods received at the Factory's warehouses;

we and the Factory are in the process of reviewing and updating the Factory's software programs, including the, management information system, to help ensure more efficient reporting.

We will continue to evaluate and monitor the Factory's and our efforts to remediate known Factory's deficiencies and will take all appropriate action when and as necessary to ensure we have effective internal controls 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)
- 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

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+ Indicates management contract or compensatory plan or arrangement.

\* In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Relates 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.



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**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Document</b>
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