

PEAK INTERNATIONAL LTD
Form 10-Q
February 13, 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 December 31, 2003

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)

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

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

None
(I.R.S. Employer Identification Number)

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

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 January 28, 2004

| <u>Class</u> | <u>Outstanding at January 28, 2004</u> |
|--------------------------------|--|
| Common Stock, \$0.01 Par Value | 12,271,008 |

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 December 31, | | | |
|---|---------------------------------|--------|-------------|--------|
| | 2003 | | 2002 | |
| | (Unaudited) | | (Unaudited) | |
| Net Sales | \$ 16,998 | 100.0% | \$ 15,115 | 100.0% |
| Cost of Goods Sold (Note 2) | 11,240 | 66.1% | 10,176 | 67.3% |
| Gross Profit | 5,758 | 33.9% | 4,939 | 32.7% |
| Selling and Marketing (Note 3) | 3,032 | 17.8% | 2,697 | 17.8% |
| General and Administrative | 1,645 | 9.7% | 1,687 | 11.2% |
| Research and Development | 68 | 0.4% | 36 | 0.2% |
| Asset Impairment (Note 15) | | 0.0% | 100 | 0.7% |
| Profit from operations | 1,013 | 6.0% | 419 | 2.8% |
| Other (Expenses) Income net | (39) | (0.2%) | 53 | 0.3% |
| Interest Income | 39 | 0.2% | 76 | 0.5% |
| Profit Before Income Taxes | 1,013 | 6.0% | 548 | 3.6% |
| Income Tax Expense (Note 4) | (120) | (0.7%) | (206) | 1.3% |
| Net Profit | \$ 893 | 5.3% | \$ 342 | 2.3% |
| PROFIT PER SHARE (Note 9) | | | | |
| Basic | \$ 0.07 | | \$ 0.03 | |
| Diluted | \$ 0.07 | | \$ 0.03 | |
| Weighted Average Number of Shares Outstanding | | | | |
| Basic | 12,208,000 | | 12,699,000 | |
| Diluted | 12,684,000 | | 12,742,000 | |

(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)

| | Nine Months Ended December 31, | | | |
|--|--------------------------------|---------------|--------------------|----------------|
| | 2003 | | 2002 | |
| | (Unaudited) | | (Unaudited) | |
| Net Sales | \$ 47,284 | 100.0% | \$ 41,915 | 100.0% |
| Cost of Goods Sold (Note 2) | 33,191 | 70.2% | 31,301 | 74.7% |
| Gross Profit | 14,093 | 29.8% | 10,614 | 25.3% |
| Selling and Marketing (Note 3) | 8,624 | 18.2% | 7,447 | 17.8% |
| General and Administrative | 4,868 | 10.3% | 5,941 | 14.2% |
| Research and Development | 172 | 0.4% | 103 | 0.2% |
| Asset impairment (Note 15) | | 0.0% | 10,584 | 25.2% |
| Profit (Loss) from operations | 429 | 0.9% | (13,461) | (32.1%) |
| Other Expenses net | (35) | (0.1%) | (40) | (0.1%) |
| Interest Income | 127 | 0.3% | 231 | 0.5% |
| Profit (Loss) Before Income Taxes | 521 | (1.1%) | (13,270) | (31.7%) |
| Income Tax Expense (Note 4) | (305) | (0.6%) | (157) | 0.3% |
| Net Profit (Loss) | \$ 216 | (0.5%) | \$ (13,427) | (32.0%) |
| PROFIT (LOSS) PER SHARE (Note 9) | | | | |
| Basic | \$ 0.02 | | \$ (1.06) | |
| Diluted | \$ 0.02 | | \$ (1.06) | |
| Weighted Average Number of Shares Outstanding | | | | |
| Basic | 12,208,000 | | 12,689,000 | |
| Diluted | 12,590,000 | | 12,689,000 | |

(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)

| | December 31, 2003 | March 31, 2003 |
|---|----------------------|-------------------|
| | (Unaudited) | |
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 23,608 | \$ 25,928 |
| Accounts receivable net of allowance for doubtful accounts of \$228 at December 31, 2003 and \$288 at March 31, 2003 | 12,314 | 10,848 |
| Inventories (Note 5) | 12,299 | 12,190 |
| Other receivables, deposits and prepayments | 1,128 | 923 |
| Total Current Assets | 49,349 | 49,889 |
| Asset to be disposed of by sale (Note 15) | 5,249 | 5,230 |
| Property, Plant and Equipment net | 27,533 | 28,073 |
| Land Use Right | 769 | 781 |
| Deposits for Acquisition of Property, Plant and Equipment | 61 | 17 |
| Income taxes receivable (Note 6) | 4,435 | 3,732 |
| Other deposit (Note 7) | 302 | 301 |
| TOTAL ASSETS | \$ 87,698 | \$ 88,023 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 4,286 | \$ 3,941 |
| Accrued payroll and employee benefits | 1,618 | 1,139 |
| Accrued other expenses | 1,241 | 1,419 |
| Income taxes payable | 5,846 | 5,721 |
| Total Current Liabilities | 12,991 | 12,220 |
| Deferred Income Taxes | 1,737 | 1,547 |
| Total Liabilities | 14,728 | 13,767 |
| Commitments and Contingencies (Note 13) | | |
| Shareholders' Equity: | | |
| Common stock, \$0.01 par value; authorized 100,000,000 shares; issued and outstanding 12,257,206 shares at December 31, 2003, and 12,664,912 shares at March 31, 2003 | 122 | 127 |
| Additional paid-in capital | 26,481 | 27,988 |
| Retained earnings | 47,470 | 47,254 |
| Accumulated other comprehensive loss | (1,103) | (1,113) |
| Total shareholders' equity | 72,970 | 74,256 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 87,698 | \$ 88,023 |

(See accompanying notes to Unaudited Condensed Consolidated Financial Statements)

Condensed Consolidated Statements of Cash Flows

(in thousands of United States Dollars)

| | Nine Months Ended | |
|--|-------------------|-------------|
| | December 31, | |
| | 2003 | 2002 |
| | (Unaudited) | (Unaudited) |
| Operating activities: | | |
| Net profit (loss) | \$ 216 | \$ (13,427) |
| Adjustments to reconcile net profit (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 4,668 | 4,731 |
| Deferred income taxes | 190 | (113) |
| Loss on disposal/write-off of property, plant and equipment | 520 | 534 |
| Allowance for doubtful accounts | (60) | 54 |
| Asset impairment | | 10,584 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,404) | (2,644) |
| Inventories | (109) | 530 |
| Other receivables, deposits and prepayments | (205) | 328 |
| Income taxes receivable | (686) | (2,914) |
| Other deposit | | (300) |
| Accounts payable-trade | 288 | 1,137 |
| Accrued payroll, employee benefits and other expenses | 301 | 545 |
| Income taxes payable | 145 | 254 |
| Net cash provided by (used in) operating activities | 3,864 | (701) |
| Investing activities: | | |
| Acquisition of property, plant and equipment | (4,481) | (1,900) |
| Proceeds on disposal of property, plant and equipment | 12 | 4 |
| (Increase) decrease in deposits for acquisition of property, plant and equipment | (44) | 20 |
| Net cash used in investing activities | (4,513) | (1,876) |
| Financing activities: | | |
| Proceeds from issuance of common stock | 904 | 189 |
| Payment for repurchase of common stock | (2,416) | (38) |
| Net cash (used in) provided by financing activities | (1,512) | 151 |
| Net decrease in cash and cash equivalents | (2,161) | (2,426) |
| Cash and cash equivalents at beginning of period | 25,928 | 29,217 |
| Effects of exchange rate changes on cash and cash equivalents | (159) | (83) |
| Cash and cash equivalents at end of period | \$ 23,608 | \$ 26,708 |
| Supplemental cash flow information: | | |
| Cash paid during the period | | |
| Interest | \$ | \$ |
| Income taxes | 693 | 2,930 |

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

(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, Italy, Korea, Malaysia, the Philippines, 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 audit, 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, 2003.

New Accounting Standards

In April 2003, the Financial Accounting Standards Board (FASB) issued SFAS No. 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies financial reporting for derivative instruments. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, with certain exceptions and for hedging relationships designated after June 30, 2003. The Company believes that the adoption of SFAS No. 149 will not significantly impact its current disclosures or results of operations, financial position or cash flows.

In May 2003, the FASB issued SFAS No. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability or an asset. SFAS No. 150 is effective for

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. The Company believes that the adoption of SFAS No. 150 will not significantly impact its current disclosures or results of operations, financial position or cash flows.

(2) Cost of goods sold

Included therein was \$31 (unaudited) and \$520 (unaudited) respectively (2002-\$45 and \$534, unaudited) write-off of machinery and molds due to technological obsolescence and capacity under-utilization for the quarter and for the nine months ended December 31, 2003.

(3) Delivery and freight expenses

For the quarter and for the nine months ended December 31, 2003, the Company incurred delivery and freight expenses of approximately \$836 (unaudited) and \$2,281 (unaudited) (2002 \$765 and \$2,062, unaudited) respectively, which have been included as part of selling and marketing expenses.

Notes to Condensed Consolidated Financial Statements (continued)

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

(4) Income Tax Expense

In June 2003, the Hong Kong Legislative Council passed a bill increasing the Hong Kong corporate tax rate from 16.0% to 17.5%. The Company revalued its deferred tax liabilities at this new rate and the impact was a \$146 charge to income tax expense recognized in the quarter ended June 30, 2003. Hong Kong tax expense has been calculated at the new rate starting from the first quarter of fiscal 2004, adjusted for permanent exclusions.

(5) Inventories

| | December 31, 2003 | March 31, 2003 |
|----------------|----------------------|-------------------|
| | (Unaudited) | |
| Raw materials | \$ 6,119 | \$ 6,858 |
| Finished goods | 6,180 | 5,332 |
| | \$ 12,299 | \$ 12,190 |

(6) Income Taxes Receivable

This represents approximately \$4,411 of tax reserve certificates purchased from the Inland Revenue Department (IRD) of Hong Kong in respect of prior year taxes that are under examination by the IRD. The placement of such certificates is a condition stipulated by the IRD.

There has been no change in the tax filing status of our Hong Kong subsidiaries since March 31, 2003.

(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, 2003 | 3,537,459 | \$ 5.96 |
| Granted | 8,000 | 3.87 |
| Forfeited | (3,825) | 8.94 |
| | <hr/> | |
| 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 |
| | <hr/> | |
| Outstanding at September 30, 2003 | 3,371,346 | 6.25 |
| Granted | 50,000 | 5.89 |
| Exercised | (100,000) | 3.66 |
| Forfeited | (493,376) | 8.47 |
| | <hr/> | |
| Outstanding at December 31, 2003 | 2,827,970 | 5.95 |

Notes to Condensed Consolidated Financial Statements (continued)

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

(8) Stock Options (con t)

| | Outstanding Options | |
|-----------------------------------|------------------------|---|
| | Number of Shares | Weighted average exercise price per share |
| Outstanding at April 1, 2002 | 2,686,894 | \$ 7.29 |
| Granted | 110,000 | 8.03 |
| Exercised | (2,000) | 3.66 |
| Forfeited | (132,511) | 9.01 |
| Outstanding at June 30, 2002 | 2,662,383 | 7.24 |
| Granted | 103,500 | 4.81 |
| Forfeited | (16,882) | 10.34 |
| Outstanding at September 30, 2002 | 2,749,001 | 7.13 |
| Granted | 363,500 | 3.58 |
| Forfeited | (20,313) | 9.52 |
| Outstanding at December 31, 2002 | 3,092,188 | 6.70 |

(9) Profit Per Share

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

| | Three Months Ended | |
|---|--------------------|-------------|
| | December 31, | |
| | 2003 | 2002 |
| | (Unaudited) | (Unaudited) |
| Numerator: | | |
| Net profit available to common shareholders | \$ 893 | \$ 342 |
| Denominator: | | |
| Weighted average number of shares outstanding | | |
| Basic | 12,208,293 | 12,698,705 |
| Assumed exercise of stock options | 475,925 | 43,398 |
| Diluted | 12,684,218 | 12,742,103 |

Notes to Condensed Consolidated Financial Statements (continued)

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

(9) Profit (Loss) Per Share (continued)

| | Nine Months Ended | |
|--|-------------------|-------------------|
| | December 31, | |
| | 2003 | 2002 |
| | (Unaudited) | (Unaudited) |
| Numerator: | | |
| Net Profit (Loss) available to common shareholders | \$ 216 | \$ (13,427) |
| Denominator: | | |
| Weighted average number of shares outstanding | | |
| Basic | 12,207,785 | 12,688,869 |
| Assumed exercise of stock options | 382,582 | |
| Diluted | 12,590,367 | 12,688,869 |

For the nine months ended December 31, 2002, exercise of all outstanding stock options would have been anti-dilutive and such stock options were therefore not included in the computation of diluted loss per share.

(10) Comprehensive Profit (Loss)

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

| | Three Months Ended | |
|------------------------------------|--------------------|---------------|
| | December 31, | |
| | 2003 | 2002 |
| | (Unaudited) | (Unaudited) |
| Net profit | \$ 893 | \$ 342 |
| Other comprehensive profit (loss): | | |
| Foreign currency translation | 142 | (42) |
| Comprehensive profit | \$ 1,035 | \$ 300 |

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

| | Nine Months Ended | |
|------------------------------------|-------------------|-------------|
| | December 31, | |
| | 2003 | 2002 |
| | (Unaudited) | (Unaudited) |
| Net profit (loss) | \$ 216 | \$ (13,427) |
| Other comprehensive profit (loss): | | |
| Foreign currency translation | 10 | (79) |
| Comprehensive profit (loss) | \$ 226 | \$ (13,506) |

Notes to Condensed Consolidated Financial Statements (continued)

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

(10) Comprehensive Profit (Loss) (continued)

| | December 31, 2003 | March 31, 2003 |
|---------------------------------------|--------------------|--------------------|
| | <u>(Unaudited)</u> | <u>(Unaudited)</u> |
| Accumulated other comprehensive loss: | | |
| Foreign currency translation | \$ (1,103) | \$ (1,113) |

(11) Employee Stock Purchase and Option Plans

During the quarter ended December 31, 2003, under the 1997 Stock Option Plan the Company issued one option for 10,000 shares to an employee of the Company at an exercise price of \$5.605 per share and one option for 10,000 shares to an employee of the Company at an exercise price of \$6.025 per share, and under the 1998 Stock Option Plan the Company issued one option for 30,000 shares to an employee of the Company at an exercise price of \$5.945 per share. The Company issued 16,572 shares at a price of \$3.88875 to employees for contributions made during the quarter ended September 30, 2003, and authorized the issuance of 11,302 shares at a price of \$4.70475 to employees for contributions made during the quarter ended December 31, 2003, under the 2000 Employee Stock Purchase Plan.

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.

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

| | Three months ended December 31, | |
|--|---------------------------------|--------------------|
| | 2003 | 2002 |
| | <u>(Unaudited)</u> | <u>(Unaudited)</u> |
| Net profit, as reported | \$ 893 | \$ 342 |
| Add: compensation expense released (recognized) under SFAS no. 123, net of tax | \$ 1,125 | \$ (646) |
| Pro forma net profit (loss) | \$ 2,018 | \$ (304) |
| Pro forma profit (loss) per share | | |
| - Basic | \$ 0.17 | \$ (0.02) |
| - Diluted | \$ 0.16 | \$ (0.02) |

| | Nine months ended December 31, | |
|--|-----------------------------------|-------------|
| | 2003 | 2002 |
| | (Unaudited) | (Unaudited) |
| Net profit (loss), as reported | \$ 216 | \$ (13,427) |
| Add: compensation expense released (recognized) under SFAS no. 123, net of tax | \$ 1,276 | \$ (1,905) |
| Pro forma net profit (loss) | \$ 1,492 | \$ (15,332) |
| Pro forma profit (loss) per share | | |
| - Basic | \$ 0.12 | \$ (1.21) |
| - Diluted | \$ 0.12 | \$ (1.21) |

Notes to Condensed Consolidated Financial Statements (continued)

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

(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 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 fiscal quarter of fiscal 2004.

(13) Commitments and Contingencies

(a) Litigation

Arbitration

The Company was involved in arbitration with Mr. Richard Brook, the Company's former chief executive officer, in which Mr. Brook alleged that his employment agreement had been breached and in which the Company alleged that Mr. Brook had acted improperly while employed by the Company. In November 2002, the arbitrator ruled in the Company's favor and awarded the Company a judgment of approximately \$520. The Company has recently sold and placed for sale property seized from Mr. Brook. The Company will record the proceeds of these sales upon receipt of funds. The Company anticipates that these sales will not fully satisfy the judgment and is uncertain whether it will be able to collect the remainder of the judgment against Mr. Brook and therefore no financial statement impact has been recorded in this respect.

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 order to obtain an anti-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 preliminary injunction order made it unlikely that Murphy or its local distributors would be able to obtain preliminary injunctive relief against the Company or its Taiwan customers during the pendency of the underlying litigation. In addition, the Company has filed a civil suit for permanent relief in connection with the preliminary injunction order. If its effort to receive permanent relief is not successful, Murphy and its distributors in Taiwan may assert patent infringement claims against the Company or its customers, which, if successful, could prevent the Company from selling certain of its products in Taiwan and could result in monetary damages. In December 2001 and July 2003, the Company also filed actions with the Taiwanese Intellectual Property Office to invalidate Murphy's patent. The Company also filed a complaint in February 2002 for unfair competition with the Fair Trade Commission against Murphy. The Fair Trade Commission dismissed the action and, on February 2, 2004, the Company filed an appeal to the High Administrative Court in Taiwan. 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.

Other litigation

The Company, one of its officers, and a former employee are parties to a lawsuit filed on February 28, 2002 by a former employee in the Superior Court of California seeking unspecified damages for alleged race discrimination, sex (pregnancy) harassment, retaliation and wrongful termination. While the Company believed it had meritorious defenses to the allegations, the suit was settled in December 2003 and the case was dismissed shortly thereafter.

(b) Commitments

At December 31, 2003, the Company had commitments for capital expenditures of approximately \$7,308.

Notes to Condensed Consolidated Financial Statements (continued)

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

(14) Segment Information

| | Hong Kong & the PRC | United States | Other Asian countries | Eliminations | Consolidated |
|---|------------------------|------------------|--------------------------|--------------|--------------|
| Quarter ended December 31, 2003 (unaudited) | | | | | |
| Net sales to third parties | \$ 7,907 | \$ 1,121 | \$ 7,970 | \$ | \$ 16,998 |
| Transfer between geographic areas | 9,025 | | 696 | (9,721) | |
| Total net sales | \$ 16,932 | \$ 1,121 | \$ 8,666 | \$ (9,721) | \$ 16,998 |
| Income (Loss) before tax | \$ 934 | \$ 53 | \$ 90 | \$ (64) | \$ 1,013 |
| Quarter ended December 31, 2002 (unaudited) | | | | | |
| Net sales to third parties | \$ 8,798 | \$ 1,921 | \$ 4,396 | \$ | \$ 15,115 |
| Transfer between geographic areas | 7,927 | | 461 | (8,388) | |
| Total net sales | \$ 16,725 | \$ 1,921 | \$ 4,857 | \$ (8,388) | \$ 15,115 |
| Income (Loss) before tax | \$ 532 | \$ 95 | \$ 130 | \$ (209) | \$ 548 |
| Nine months ended December 31, 2003 (unaudited) | | | | | |
| Net sales to third parties | \$ 21,953 | \$ 2,837 | \$ 22,494 | \$ | \$ 47,284 |
| Transfer between geographic areas | 24,938 | | 1,949 | (26,887) | |
| Total net sales | \$ 46,891 | \$ 2,837 | \$ 24,443 | \$ (26,887) | \$ 47,284 |
| Income (Loss) before tax | \$ 427 | \$ 253 | \$ 103 | \$ (262) | \$ 521 |
| Nine months ended December 31, 2002 (unaudited) | | | | | |
| Net sales to third parties | \$ 26,109 | \$ 5,054 | \$ 10,752 | \$ | \$ 41,915 |
| Transfer between geographic areas | 19,568 | | 1,323 | (20,891) | |
| Total net sales | \$ 45,677 | \$ 5,054 | \$ 12,075 | \$ (20,891) | \$ 41,915 |
| (Loss) Income before tax | \$ (12,975) | \$ 189 | \$ (199) | \$ (285) | \$ (13,270) |

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

A subsidiary of the Company, operating in Shenzhen in the PRC, owns a factory under construction in the PRC. In view of its production needs and market conditions, the completion of the factory under construction was delayed.

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

The factory under construction and the related land use right in the PRC 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 during the quarter ended June 30, 2002. The property has been written down to its fair market value pursuant to the SFAS No. 144 Accounting for the Impairment of Disposal of Long-Lived Assets, resulting in an asset impairment charge of \$10,484, \$100 and \$2,794 respectively in the first quarter, the third quarter and the fourth quarter of fiscal 2003. Management of the Company has been actively marketing this asset for sale since the decision to sell the factory.

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, 2003.

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, statements regarding our capital expenditures, 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, 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

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

Net Sales. Net sales increased by approximately 12.4% to \$17.0 million in the third quarter of fiscal 2004 from \$15.1 million in the same quarter of fiscal 2003. The increase was primarily due to an increase in sales of our semiconductor trays, tapes and reels. It reflected an improvement in demand for most of our products, particularly semiconductor trays. Net sales of semiconductor trays increased by 28.0% over the same period last year reflecting a 38.3% increase in sales volume, and a 7.4% drop in average realized sales price. For the third quarter of fiscal 2004, net sales of tapes and reels increased by 11.9% compared to the third quarter of fiscal 2003, primarily due to a 20.0% increase in sales volume combined with a 6.8% drop in average realized sales price. Net sales for tubes increased by 19.8% compared to the same period last year, primarily due to a 32.8% increase in sales volume for tubes and a decrease of 9.8% in the average realized sales price of tubes. Net sales for disk drive trays decreased by 48.8% compared to the same period last year, driven by a volume decrease of 53.0% while the average realized sales price increased by 9.1%.

Net sales increased by 12.8% to \$47.3 million for the nine months ended December 31, 2003 from \$41.9 million for the nine months ended December 31, 2002. The increase was primarily due to an increase in sales of our semiconductor trays, tapes and reels. Net sales of semiconductor trays increased by 20.8% comparing the nine months ended December 31, 2003 to the nine

months ended December 31, 2002, primarily due to an increase in sales volume by 28.8% and a 6.2% drop in average realized sales price. Net sales of tapes and reels increased by 4.6% comparing the nine months ended December 31, 2003 to the nine months ended December 31, 2002, primarily due to a 17.6% increase in sales volume, and a 11.1% drop in average realized sales price. Net sales of tubes decreased by 4.2% comparing the nine months ended December 31, 2003 to the nine months ended December 31, 2002, reflecting a 16.2% increase in sales volume and a 17.5% drop in average realized sales price. Net sales of disk drive trays decreased by 9.7% comparing the nine months ended December 31, 2003 to the nine months ended December 31, 2002, reflecting a 13.7% drop in sales volume, and a 4.7% increase in average realized sales price. The increase in net sales resulted from an increase in sales volume primarily due to a better business environment in the semiconductor industry, while the drop in average realized sales price was primarily due to increased competition and product mix changes.

The semiconductor industry is recovering from a downturn that began in 2001. Customers put significant pressure on suppliers, including Peak, to reduce prices. Some of the effects of reduced prices were offset by cost reduction programs and higher semiconductor tray volumes.

Gross Profit. Gross profit increased to \$5.8 million in the third quarter of fiscal 2004 from \$4.9 million in the third quarter of fiscal 2003. Gross margin as a percentage of sales improved to 33.9% in the third quarter of fiscal 2004 from 32.7% in the same quarter of fiscal 2003. The increases in gross profit and gross margin were primarily the result of higher semiconductor tray sales and cost reduction programs.

Gross profit increased to \$14.1 million for the nine months ended December 31, 2003 from \$10.6 million for the nine months ended December 31, 2002. Gross margin improved from 25.3% for the nine months ended December 31, 2002 to 29.8% for the nine months ended December 31, 2003. The increases in gross profit and gross margin were primarily due to better economies of scale in light of the increased sales volume and favorable product mix shift.

Profit (Loss) from Operations. An operating profit of \$1.0 million was recorded in the third quarter of fiscal 2004 compared to an operating profit of \$0.4 million in the third quarter of fiscal 2003. Operating margin improved from 2.8% to 6.0% when comparing the third quarter of fiscal 2004 to the third quarter of fiscal 2003. The improvement in operating income was due primarily to improved gross margin, a quarter over quarter increase in net sales and improved factory utilization, as well as the recognition of an asset impairment charge in the amount of \$0.1 million in the third quarter of fiscal 2003.

An operating profit of \$0.4 million was recorded for the nine months ended December 31, 2003, compared with an operating loss \$13.5 million for the nine months ended December 31, 2002. The improvement in operating results was due primarily to increased net sales, better factory utilization, savings in general and administrative expenses and the recognition of an asset impairment charge in the aggregate amount of \$10.6 million in the first and third quarter of fiscal 2003.

Selling and Marketing. Selling and marketing expenses increased by 12.4% to \$3.0 million in the third quarter of fiscal 2004 from \$2.7 million in the third quarter of fiscal 2003, primarily due to increases in freight charges and delivery expenses resulting from increased business volume and additional staff and facilities costs related to our new Advanced Products Group located in Southern California.

Selling and marketing expenses increased by 15.8% to \$8.6 million for the nine months ended December 31, 2003 from \$7.4 million for the nine months ended December 31, 2002, primarily due to increases in freight charges and delivery expenses resulting from increased business volume and additional staff and facility costs related to our new Advanced Products Group.

General and Administrative. General and administrative expenses decreased by 2.5% to \$1.6 million in the third quarter of fiscal 2004 from \$1.7 million in the third quarter of fiscal 2003 primarily due to savings in salaries and rentals and savings from other cost reduction programs.

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

General and administrative expenses decreased by 18.1% to \$4.9 million for the nine months ended December 31, 2003 from \$5.9 million for the nine months ended December 31, 2002 primarily due to savings in salaries and rentals as well as savings from other cost reduction programs and a decrease in legal and professional fees resulting from the settlement of outstanding lawsuits.

Other (Expenses) Income net. Other (Expenses) Income net primarily represented differences in realized and unrealized exchange (losses) gains that we recorded arising from transactions in foreign currencies. During the third quarter of fiscal 2004, a net exchange loss of \$39,000 was recorded compared to a net exchange gain of \$53,000 recorded in the third quarter of fiscal 2003. The loss was primarily due to unfavorable movements of the US Dollar against the Yen and Euro.

Other (Expenses) Income net decreased by 12.5% to a net expense of \$35,000 for the nine months ended December 31, 2003 from a net expense of \$40,000 for the nine months ended December 31, 2002, primarily due to the fluctuation of Asian currencies against the US Dollar.

Interest Income. Interest income decreased by 48.7% to \$39,000 for the third quarter of fiscal 2004 from \$76,000 for the third quarter of fiscal 2003 primarily due to reductions in bank deposit interest rates and average cash balances.

Interest income decreased by 45.0% to \$0.1 million for the nine months ended December 31, 2003 from \$0.2 million for the nine months ended December 31, 2002, primarily due to reductions in bank deposit interest rates and cash balances.

Income Tax Expense. An income tax expense of \$0.1 million was recorded for the third quarter of fiscal 2004, compared to an income tax expenses of \$0.2 million recorded in the third quarter of fiscal year 2003.

A \$0.3 million tax expense was recorded for the nine months ended December 31, 2003, compared with a tax expense of \$0.2 million recorded for the same period last year.

Net Profit (Loss). We had a net profit of approximately \$0.9 million for the third quarter of fiscal 2004, compared to a net profit of \$0.3 million for the same quarter of fiscal 2003, reflecting the effects of the previously discussed factors.

We had a net profit of \$0.2 million for the nine months ended December 31, 2003, compared to a net loss of \$13.4 million for the nine months ended December 31, 2002, primarily due to the recognition of an asset impairment charge in the aggregate amount of \$10.6 million in the first and third quarter of fiscal 2003 and as a result of the foregoing factors.

Profit (Loss) Per Share. Diluted profit per share for the third quarter of fiscal 2004 was \$0.07, compared to a diluted profit per share of \$0.03 for the same period last year, reflecting the effects of the foregoing factors.

Diluted profit per share for the nine months ended December 31, 2003 was \$0.02 compared to a diluted loss per share for the nine months ended December 31, 2002 of \$1.06, primarily due to the recognition of an asset impairment charge in the aggregate amount of \$10.6 million in the first and third quarter of fiscal 2003 and as a result of the foregoing factors.

Liquidity and Capital Resources

Our net cash provided by operating activities was \$3.9 million for the nine months ended December 31, 2003, compared to net cash used in operating activities of \$0.7 million for the nine months ended December 31, 2002. This increase in net cash provided by operating activities was primarily due to the reduction in operating losses and improved collections as well as the decrease in the amount of tax reserve certificates we were required to purchase.

Net cash used in investing activities was \$4.5 million for the nine months ended December 31, 2003, compared to \$1.9 million for nine months ended December 31, 2002. This increase was primarily due to capital expenditures of \$4.5 million for the acquisition of new equipment for our Shenzhen, PRC factory during the nine months ended December 31, 2003.

Net cash used in financing activities was \$1.5 million for the nine months ended December 31, 2003, compared to net cash provided by financing activities of \$0.1 million for the nine months ended December 31, 2002. The increase in net cash used in financing activities was primarily due to the repurchase of shares of our common stock worth \$2.4 million during the first quarter of 2004.

As of December 31, 2003, we had commitments for capital expenditures of \$7.3 million and had no outstanding bank borrowings. Our cash and cash equivalents balance at December 31, 2003 was \$23.6 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 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

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

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.

New Accounting Standards

In April 2003, the Financial Accounting Standards Board (FASB) issued SFAS No. 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies financial reporting for derivative instruments. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, with certain exception and for hedging relationships designated after June 30, 2003. We believe that the adoption of SFAS No. 149 will not significantly impact our current disclosures or results of operations, financial position or cash flows.

In May 2003, the FASB issued SFAS No. 150 Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within

its scope as a liability or an asset. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. We believe that the adoption of SFAS No. 150 will not significantly impact our current disclosures or results of operations, financial position or cash flows.

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;

factors relating to conditions in the semiconductor, disk drive and electronics 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 electronics 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;

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

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

our ability to sell our new plant that is substantially completed;

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

production volume fluctuations and the management of our inventories;

currency fluctuations;

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 required by the PRC due to violations of its rules 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, decreased demand for disk drive trays or 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 semiconductor industry is 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 60.0%, 59.5% and 53.8% of our net sales in fiscal 2003, fiscal 2002 and fiscal 2001, 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. 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 electronics 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.

One of our largest customers, ASAT used to be a subsidiary of QPL Holdings and was indirectly controlled by Mr. T. L. Li, a large shareholder of PEAK. In October 1999, a contract was signed by QPL Holdings with a group of financial institutions to dispose of 50% interest in ASAT, removing it from the exclusive control of QPL Holdings, and therefore from the control of Mr. T. L. Li. In October 2001, Mr. T. L. Li retired from our board of directors and QPL Holdings ceased to be a related company. Over time, this may result in QPL Holdings and ASAT fulfilling less of their needs with orders from us.

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 December 31, 2003, 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 by an unaffiliated PRC company under a processing agreement, pursuant to which this company provides all of the personnel for the operation of our facilities and renders assistance in dealing with matters relating to the import of raw materials and the export of our products. Our existing production facilities in Shenzhen, the PRC are located on land leased from the PRC government since May 1, 1992 by one of our wholly-owned subsidiaries under land use certificates and agreements with terms of fifty years and have an unexpired lease period of thirty-eight years and four months as of December 31, 2003. 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.

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

The operations of our production facilities in Shenzhen, the PRC may be adversely affected 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 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 completed formation of a wholly owned subsidiary in the PRC and hence a small portion of our products are currently 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 substantial amounts of material for ultimate sale in the PRC, and may be subject to significantly higher administrative importation

costs generally. Being subjected to these measures could harm our ability to manufacture products at competitive prices 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 capital 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, stricter regulations or interpretations of existing regulations which would require additional expenditures.

The economy of the PRC differs from the economies of many countries in many respects including 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 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.

A number of lawsuits have been filed against us in recent years, including securities class action litigation, as well as other lawsuits related to intellectual property infringement and employee terminations. While these lawsuits vary greatly in the materiality of potential liability associated with them, the uncertainty associated with substantial unresolved lawsuits 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.

The continued defense of the lawsuits also could result in continued diversion of our management's time and attention away from business operations, which could harm our business. Negative developments with respect to the lawsuits could cause the price of our common stock to decline significantly. In addition, although we are unable to determine the amount, if any, that we may be required to pay in connection with the resolution of these lawsuits by settlement or otherwise, the size of any such payments, individually or in the aggregate, could seriously harm our financial condition. Many of the complaints associated with these lawsuits do not specify the amount of damages that plaintiffs seek. As a result, we are unable to estimate the possible range of damages that might be incurred as a result of the lawsuits. For more information about the specific claims filed against, 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:

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

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;

other risks relating to changes, administration or new interpretations of laws, regulations and policies of 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 electronics 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.

One of our largest shareholders and former chairman of our Board of Directors, is affiliated with several of our customers.

Mr. T. L. Li, who retired from the Board of Directors in October 2001, through his ownership of all of the outstanding shares of Luckygold 18A Limited, a company incorporated in the British Virgin Islands, beneficially owns, as of December 31, 2003, approximately 11.42% of the outstanding shares of our common stock. In addition, Mr. T. L. Li serves as director of companies affiliated with QPL Holdings.

A significant portion of our net sales historically has been and is expected to continue to be made to companies controlled by Mr. T. L. Li and companies affiliated with QPL Holdings. These affiliated companies together accounted for approximately 2.9%, 2.5% and 8.7% of our net sales in fiscal 2003, fiscal 2002 and fiscal 2001 respectively. Accordingly, any adverse development in the operations, competitive position or customer base of ASAT or companies affiliated with QPL Holdings or our relationship with the companies affiliated with QPL Holdings could have a material adverse effect on our results of operations and financial condition. Mr. T. L. Li may take actions as the controlling shareholder of the companies affiliated with QPL Holdings that are not in our best interests or the best interests of our shareholders.

In addition, in October 1999, a contract was signed with a group of financial institutions to dispose of a 50% interest in ASAT Limited, removing it from the exclusive control of QPL Holdings, and therefore from the control of Mr. T.L. Li. This, combined with the fact Mr. T. L. Li retired from our Board of Directors may result in QPL Holdings and ASAT Limited fulfilling less of their needs with orders from us.

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 because of stock market fluctuations that affect the price of technology stocks. 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.

Edgar Filing: PEAK INTERNATIONAL LTD - Form 10-Q

Our stock price has been and is likely to continue to be highly volatile. Between October 1, 2003 and December 31, 2003, our stock price has traded as high as \$6.44 on December 12, 2003, and as low as \$5.40 on October 10, 2003. 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 raw material used in the manufacture of tubes, together with additives used in the manufacture of tubes accounted for 9.2% and 11.9% of total raw material costs for the three months and nine months ended December 31, 2003. While we believe that a severe shortage in the supply of PVC compound is unlikely to occur in the foreseeable future because of increased production capacity of suppliers, 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 one to two 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. The Chinese government may change its position regarding its policy of a fixed exchange rate between the US dollar and the Renminbi. Implementation of a floating of the Renminbi would likely have an adverse impact of Peak's manufacturing costs. 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. Primarily in response to recent developments in the Southeast Asian currency markets, from time to time, we engage in derivatives trading activities, such as entering into forward contracts, to hedge our currency exchange exposure. The Company does not utilize market-risk sensitive instruments for speculative purposes. At December 31, 2003, 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. 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 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 order to obtain an anti-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 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 made it unlikely that Murphy or its local distributors would be able to obtain preliminary injunctive relief against us or our Taiwan customers during the pendency of the underlying litigation. In addition, we filed a civil suit for permanent relief in connection with the preliminary injunction order. If our effort to receive permanent relief is not successful, Murphy and its distributors in Taiwan may assert patent infringement claims against us and our customers which, if successful, could prevent us from selling certain of our products in Taiwan and could result in monetary damages. In December 2001 and July 2003, we also filed actions with the Taiwanese Intellectual Property Office to invalidate Murphy's patent. We also filed a complaint in February 2002 for unfair competition with the Fair Trade Commission against Murphy. The Fair Trade Commission dismissed the action and, on February 2, 2004, we filed an appeal to the High Administrative Court in Taiwan. 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.

Peak, one of its officers, and a former employee were parties to a lawsuit filed on February 28, 2002 by a former employee in the Superior Court of California seeking unspecified damages for alleged race discrimination, sex (pregnancy) harassment, retaliation and wrongful termination. While we believed we had meritorious defenses to the allegations, the suit was settled in December 2003 and the lawsuit was dismissed shortly thereafter.

Item 2. *Changes in 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 and Reports on Form 8-K

a. 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

b. Reports on Form 8-K.

On October 23, 2003, the Company filed a Current Report on Form 8-K furnishing under item 12 the Company's press release relating to its financial results for fiscal quarter ended September 30, 2003.

EXHIBIT INDEX

| Exhibit Number | Description of Document |
|---------------------------|--|
| 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 |