

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB

(MARK ONE)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1998
- 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 - 0-28104

JAKKS PACIFIC, INC.
(EXACT NAME OF SMALL BUSINESS ISSUER AS SPECIFIED IN ITS CHARTER)

DELAWARE
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

95-4527222
(I.R.S. EMPLOYER
IDENTIFICATION NO.)

22761 PACIFIC COAST HWY.
MALIBU, CALIFORNIA
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

90265
(ZIP CODE)

ISSUER'S TELEPHONE NUMBER, INCLUDING AREA CODE: (310) 456-7799

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the past 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

The number of shares outstanding of the issuer's common stock is 5,959,459 (as of November 16, 1998).

Transitional Small Business Disclosure Format (check one): Yes No

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JAKKS PACIFIC, INC. AND SUBSIDIARIES
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FILED WITH THE SECURITIES AND EXCHANGE COMMISSION
QUARTER ENDED SEPTEMBER 30, 1998

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheet
September 30, 1998 (Unaudited)

Assets

| | |
|--|--------------|
| Current assets | |
| Cash and cash equivalents | \$ 6,601,170 |
| Accounts receivable, net | 18,775,495 |
| Inventory, net | 3,030,416 |
| Deferred product development costs, net | 594,952 |
| Advance royalty payments, net | 208,750 |
| Prepaid expenses and other current assets | 1,117,172 |
| | ----- |
| Total current assets | 30,327,955 |
| | ----- |
| Property and equipment, at cost | 6,453,644 |
| Less accumulated depreciation and amortization | 2,308,061 |
| | ----- |
| Net property and equipment | 4,145,583 |
| | ----- |
| Deferred offering costs, net | 428,456 |
| Goodwill, net | 10,416,044 |
| Trademarks and Patents, net | 13,705,260 |
| Investment in joint venture | 1,044,708 |
| Other | 367,356 |
| | ----- |
| Total assets | \$60,435,362 |
| | ===== |

Liabilities and Stockholders' Equity

| | |
|--|--------------|
| Current liabilities | |
| Accounts payable and accrued expenses | \$16,068,105 |
| Current portion of debt | 240,000 |
| Income taxes payable | 2,056,880 |
| | ----- |
| Total current liabilities | 18,364,985 |
| | ----- |
| Convertible Debentures | 6,000,000 |
| Deferred income taxes | 86,896 |
| | ----- |
| Total liabilities | 24,451,881 |
| | ----- |
| Commitments | |
| Stockholders' equity | |
| Preferred stock, \$.001 par value; 5,000 shares Authorized, 1,000 shares issued and outstanding | 1 |
| Common stock, \$.001 par value; 25,000,000 shares authorized; 5,937,292 shares issued and outstanding | 5,937 |
| Additional paid-in capital | 26,806,223 |
| Retained earnings | 9,256,733 |
| | ----- |
| | 36,068,894 |
| Less unearned compensation from stock option grants | 85,413 |
| | ----- |
| Net stockholders' equity | 35,983,481 |
| | ----- |
| Total liabilities and stockholders' equity | \$60,435,362 |
| | ===== |

See accompanying notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations
 For the Three and Nine Months Ended September 30, 1998 and 1997 (Unaudited)

| | THREE MONTHS ENDED SEPTEMBER 30, | | NINE MONTHS ENDED SEPTEMBER 30, | |
|--|----------------------------------|---------------|---------------------------------|---------------|
| | 1998 | 1997 | 1998 | 1997 |
| Net sales | \$ 34,218,151 | \$ 15,919,154 | \$ 61,379,402 | \$ 29,212,906 |
| Cost of sales | 20,976,452 | 9,299,135 | 37,669,477 | 17,479,001 |
| Gross profit | 13,241,699 | 6,620,019 | 23,709,925 | 11,733,905 |
| Selling, general and administrative expenses | 8,173,172 | 4,599,163 | 16,447,200 | 8,819,249 |
| Income from operations | 5,068,527 | 2,020,856 | 7,262,725 | 2,914,656 |
| Other (income) and expense: | | | | |
| Other expense | 319,838 | -- | 319,838 | -- |
| Interest income | (47,868) | (60,116) | (98,917) | (228,409) |
| Interest expense | 148,208 | 173,064 | 467,638 | 507,186 |
| Income before income taxes | 4,648,349 | 1,907,908 | 6,574,166 | 2,635,879 |
| Provision for income taxes | 1,214,078 | 452,449 | 1,720,069 | 520,385 |
| Net income | 3,434,271 | 1,455,459 | 4,854,097 | 2,115,494 |
| Net income per share - basic | \$ 0.58 | \$ 0.30 | \$ 0.87 | \$ 0.47 |
| Net income per share - diluted | \$ 0.45 | \$ 0.29 | \$ 0.68 | \$ 0.45 |

See accompanying notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows
For the Nine Months Ended September 30, 1998 and 1997 (Unaudited)

| | NINE MONTHS ENDED SEPTEMBER 30, | |
|--|---------------------------------|--------------|
| | 1998 | 1997 |
| | ----- | ----- |
| Cash flows from operating activities: | | |
| Net income | \$ 4,854,097 | \$ 2,115,494 |
| | ----- | ----- |
| Adjustments to reconcile net income to net cash provided (used) by operating activities: | | |
| Depreciation and amortization | 2,643,930 | 1,042,979 |
| Change in accounts receivable | (10,039,967) | (5,962,612) |
| Change in inventory | (1,082,166) | (2,138,373) |
| Change in accounts payable and accrued expenses | 8,926,848 | 5,615,264 |
| Net change in other operating assets and liabilities | (213,241) | (1,052,875) |
| | ----- | ----- |
| Total adjustments | 235,404 | (2,495,617) |
| | ----- | ----- |
| Net cash provided (used) by operating activities | 5,089,501 | (380,123) |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (2,911,011) | (1,579,957) |
| Excess of cost over toy business assets acquired (goodwill) | -- | (7,063,704) |
| Acquisition cost of trademarks | (12,252) | (1,000,000) |
| Investment in joint venture | (1,044,708) | -- |
| Increase in other assets | (75,350) | (39,687) |
| | ----- | ----- |
| Net cash used by investing activities | (4,043,321) | (9,683,348) |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Repayment of bank debt | (114,700) | -- |
| Proceeds from issuance of convertible debentures | -- | 6,000,000 |
| Offering costs - convertible debentures | -- | (528,532) |
| Proceeds from sale of common stock | -- | 4,000,750 |
| Offering costs-- common stock | -- | (1,026,102) |
| Proceeds from sale of convertible preferred stock | 5,000,000 | -- |
| Offering costs - convertible preferred stock | (207,570) | -- |
| Proceeds from acquisition debt | -- | 6,391,838 |
| Repayment of acquisition debt | (2,006,376) | (4,490,641) |
| Proceeds from exercise of options | 347,711 | -- |
| | ----- | ----- |
| Net cash provided by financing activities | 3,019,065 | 10,347,313 |
| | ----- | ----- |
| Net increase in cash and cash equivalents | 4,065,245 | 283,842 |
| Cash and cash equivalents, beginning of period | 2,535,925 | 6,355,260 |
| | ----- | ----- |
| Cash and cash equivalents, end of period | \$ 6,601,170 | \$ 6,639,102 |
| | ===== | ===== |
| Supplemental disclosure of cash flow information (Note 4): Cash paid during the period for: | | |
| Income taxes | \$ 266,803 | \$ -- |
| | ===== | ===== |
| Interest | \$ 505,245 | \$ 460,451 |
| | ===== | ===== |

See accompanying notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 1998

Note 1 - Basis of presentation

The accompanying 1998 and 1997 unaudited interim condensed consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to prevent the information presented from being misleading. These financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's Form 10-KSB, which contains financial information for the years ended December 31, 1997 and 1996.

The information provided in this report reflects all adjustments (consisting solely of normal recurring accruals) that are, in the opinion of management, necessary to present fairly the results of operations for this period. The results for this period are not necessarily indicative of the results to be expected for the full year.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries.

Basic earnings per share has been computed using the weighted average number of common shares. Diluted earnings per share has been computed using the weighted average number of common shares and common share equivalents (which consist of warrants, options and convertible securities, to the extent they are dilutive).

Note 2 -- Earnings per share

In February 1997, the Financial Accounting Standards Board issued SFAS No. 128, "Earnings per Share." This statement, which is effective for financial statements issued for periods ending after December 15, 1997, including interim periods, establishes simplified standards for computing and presenting earnings per share (EPS). It requires dual presentation of basic and diluted EPS on the face of the income statement for entities with complex capital structures and disclosure of the calculation of each EPS amount.

| | THREE MONTHS ENDED SEPTEMBER 30, | | | | | |
|--|----------------------------------|-------------------------------|---------------|--------------|-------------------------------|---------------|
| | 1998 | | | 1997 | | |
| | INCOME | WEIGHTED AVERAGE SHARES | PER- SHARE | INCOME | WEIGHTED AVERAGE SHARES | PER- SHARE |
| Net income per share - basic | | | | | | |
| Net Income available to common Stockholders | \$ 3,434,271 | 5,932,673 | \$ 0.58 | \$ 1,455,459 | 4,876,204 | \$ 0.30 |
| Effect of dilutive securities | | | | | | |
| Options and warrants | -- | 337,251 | -- | -- | -- | -- |
| 9% convertible debentures | 93,183 | 1,043,478 | -- | -- | 215,577 | -- |
| 4% convertible preferred stock | -- | -- | -- | -- | -- | -- |
| 7% convertible preferred stock | -- | 558,658 | -- | -- | -- | -- |
| Net income per share - diluted | | | | | | |
| Income available to common stockholders plus assumed conversions | \$ 3,527,454 | 7,872,060 | \$ 0.45 | \$ 1,455,459 | 5,091,781 | \$ 0.29 |

| | NINE MONTHS ENDED SEPTEMBER 30, | | | | | |
|--|---------------------------------|-------------------------------|---------------|--------------|-------------------------------|---------------|
| | 1998 | | | 1997 | | |
| | INCOME | WEIGHTED AVERAGE SHARES | PER- SHARE | INCOME | WEIGHTED AVERAGE SHARES | PER- SHARE |
| Net income per share - basic | | | | | | |
| Net Income available to common Stockholders | \$ 4,854,097 | 5,595,305 | \$ 0.87 | \$ 2,115,494 | 4,516,519 | \$ 0.47 |
| Effect of dilutive securities | | | | | | |
| Options and warrants | -- | 267,910 | -- | -- | 178,212 | -- |
| 9% convertible debentures | 279,549 | 1,043,478 | -- | -- | -- | -- |
| 4% convertible preferred stock | -- | 304,117 | -- | -- | -- | -- |
| 7% convertible preferred stock | -- | 373,808 | -- | -- | -- | -- |
| Net income per share - diluted | | | | | | |
| Income available to common stockholders plus assumed conversions | \$ 5,133,646 | 7,584,618 | \$ 0.68 | \$ 2,115,494 | 4,694,731 | \$ 0.45 |

Note 3 -- Preferred stock and common stock

On March 30, 1998, holders of all of the 3,525 shares of the Company's 4% Convertible Preferred Stock converted all such shares into 939,998 shares of the Company's common stock.

On April 1, 1998, the Company issued 1,000 shares of its 7% Series A Cumulative Convertible Preferred Stock at a price of \$5,000 per share in connection with a private placement to two investors. The Company received net proceeds of approximately \$4.8 million after legal, placement and closing costs. Such shares are initially convertible into 558,658 shares of common stock based on a conversion price of \$8.95 per share.

Note 4 -- Supplemental information to condensed consolidated statements of cash flows

198,020 shares of common stock were issued as partial consideration for toy business assets acquired totalling \$1,500,000 in 1997. The excess of cost over toy business assets acquired (goodwill) is reflected in the consolidated statement of cash flows net of the stock issued.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion and analysis should be read together with the Company's Condensed Consolidated Financial Statements and Notes thereto which appear elsewhere herein.

OVERVIEW

The Company was founded in early 1995 to develop, manufacture and market toys and related products for children. The Company commenced business operations as of July 1, 1995, when it assumed operating control over the toy business of Justin Products Limited ("Justin") and has included the results of Justin's operations in its consolidated financial statements from the effective date of such acquisition (the "Justin Acquisition"). The Justin product lines accounted for substantially all of the Company's sales for the period from April 1, 1995 (Inception) to December 31, 1995.

In 1996, the Company expanded its product lines to include products based on licensed characters and properties such as WWF action figures and Power Rangers ZEO mini vehicles. Presently, the Company's products include (i) toys and action figures featuring licensed characters, including action figures based on characters from the WWF, (ii) die cast collectible and toy vehicles marketed under the names Road Champs and Remco, (iii) Child Guidance pre-school toys, (iv) fashion dolls with related accessories and (v) electronic toys designed for children.

In February 1997, the Company acquired Road Champs with its line of die cast collectible and toy vehicles. The Company has included the results of operations of Road Champs from February 1, 1997, the effective date of the acquisition.

In October 1997, the Company acquired the Child Guidance and Remco trademarks, under which the Company markets pre-school toys and metal trucks, respectively. Such lines contributed nominally in 1997, but have begun to contribute more significantly to operations in 1998.

The toys sold by the Company are currently primarily produced by non-affiliated manufacturers located in China on letter of credit basis or on open account and are shipped F.O.B. Hong Kong. These methods allow the Company to keep certain operating costs down and reduce working capital requirements. However, through the Company's Road Champs division, a portion of the Company's sales are made on a domestic basis, for which the Company holds certain inventory in a warehouse operated by a non-affiliated third party. To date, substantially all of the Company's sales have been to domestic customers. The Company intends to expand distribution of its products internationally.

The Company's products are generally acquired from others or developed for the Company by non-affiliated third parties, thus minimizing operating costs. Royalties payable to such product developers generally range from 1% to 6% of the net sales price for each unit of a product sold by the Company.

RESULTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, 1998 AND 1997

Net Sales. Net sales were \$34.2 million in 1998, an increase of \$18.3 million, or 115% over \$15.9 million in 1997. The significant growth in net sales was due primarily to the continuing growth of the WWF action figure product line with its expanded product offerings and frequent character releases. The Company's holiday doll line performed comparably with the prior year and its new lines of Remco toy vehicles and Child Guidance pre-school toys contributed to net sales in 1998.

Gross Profit. Gross profit was \$13.2 million, or 38.7% of net sales, in 1998. This represents an increase of approximately 100% over gross profit of \$6.6 million, or 41.6% of net sales, in 1997. The decrease in gross profit as a percentage of net sales was due to the change in product mix with lower-margin non-licensed products accounting for a higher proportion of net sales in 1998 than in 1997. The overall increase in gross profit was attributable to the significant increase in net sales.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$8.2 million in 1998 and \$4.6 million in 1997, constituting 23.9% and 28.9% of net sales, respectively. The overall significant increase of \$3.6 million in such costs was due in part to costs incurred in support of the Company's development and marketing of products under its recently acquired Child Guidance and Remco trademarks. Selling, general and administrative expenses decreased as a percentage of net sales due in part to the fixed nature of certain of these expenses. The overall dollar increase was also due to the significant increase in net sales with its proportionate impact on variable selling costs such as freight and shipping related expenses, sales commissions, cooperative advertising and travel expenses, among others. From time to time, the Company may increase its advertising efforts, including the use of more expensive advertising media such as television, if the Company deems it appropriate for particular products. Such advertising costs may be substantial, and there is no certainty as to the effectiveness of such advertising or whether any resultant sales would be sufficient to cover such costs.

Interest. The Company had moderately lower interest-bearing obligations in 1998 than in 1997 with its convertible debentures and seller note issued to partially fund the Road Champs Acquisition and Child Guidance/Remco trademark acquisitions, respectively. In addition, the Company had lower average cash balances during 1998 than in 1997.

Provision for Income Taxes. Provision for income taxes include Federal, state and foreign income taxes in 1998 and also include a tax benefit generated by operating losses for Federal and state purposes in 1997. The Company's earnings benefit from a flat 16.5% Hong Kong Corporation Tax on its income arising in, or derived from, Hong Kong. At December 31, 1997, the Company had Federal and state net operating loss carryforwards of \$727,000 and \$306,000, respectively, available to offset future taxable income. The carryforwards generally expire through 2012 and may be subject to annual limitations as a result of changes in the Company's ownership. There can be no assurances that changes in ownership in future periods or any future losses will not significantly limit the Company's use of the net operating loss carryforwards. In addition, no valuation allowance for its deferred tax assets, amounting to approximately \$258,000 at December 31, 1997, has been provided for since, in the opinion of management, realization of the future benefit is probable. In making this determination, management considered all available evidence, both positive and negative, as well as the weight and importance given to such evidence.

NINE MONTHS ENDED SEPTEMBER 30, 1998 AND 1997

Net Sales. Net sales were \$61.4 million in 1998, an increase of \$32.2 million, or 110% over \$29.2 million in 1997. The significant growth in net sales was due primarily to the continuing growth of the WWF action figure product line with its expanded product offerings and frequent character releases, as well as to the full year to date contribution made by Road Champs' sales of die-cast toy and collectible vehicle, which have been included from the effective day of the acquisition, February 1, 1997. The Company's holiday doll line performed comparably with the prior year and its new lines of Remco toy vehicles and Child Guidance pre-school toys contributed to net sales in 1998.

Gross Profit. Gross profit was \$23.7 million, or 38.6% of net sales, in 1998. This represents an increase of approximately 102% over gross profit of \$11.7 million, or 40.2% of net sales, in 1997. The decrease in gross profit as a percentage of net sales was due to the change in product mix with lower-margin non-licensed products accounting for a higher proportion of net sales in 1998 than in 1997. The overall increase in gross profit was attributable to the significant increase in net sales.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$16.4 million in 1998 and \$8.8 million in 1997, constituting 26.8% and 30.2% of net sales, respectively. The overall significant increase of \$7.6 million in such costs was due in part to the full year to date impact of costs associated with the infrastructure added in connection with the Road Champs Acquisition, with its sales, administration and warehousing operations in the United States and Hong Kong as well as to costs incurred in support of the Company's development and marketing of products under its recently acquired Child Guidance and Remco trademarks. Selling, general and administrative expenses decreased as a percentage of net sales due in part to the fixed nature of certain of these expenses. The overall dollar increase was also due to the significant increase in net sales with its proportionate impact on variable selling costs such as freight and shipping related expenses, sales commissions, cooperative advertising and travel expenses, among others. From time to time, the Company may increase its advertising efforts, including the use of more expensive advertising media such as television, if the Company deems it appropriate for particular products. Such advertising costs may be substantial, and there is no certainty as to the effectiveness of such advertising or whether any resultant sales would be sufficient to cover such costs.

Interest. The Company had moderately lower interest-bearing obligations in 1998 than in 1997 with its convertible debentures and seller note issued to partially fund the Road Champs Acquisition and Child Guidance/Remco trademark acquisitions, respectively. In addition, the Company had significantly lower average cash balances during 1998 than in 1997.

Provision for Income Taxes. Provision for income taxes include Federal, state and foreign income taxes in 1998 and also include a tax benefit generated by operating losses for Federal and state purposes in 1997. The Company's earnings benefit from a flat 16.5% Hong Kong Corporation Tax on its income arising in, or derived from, Hong Kong. At December 31, 1997, the Company had Federal and state net operating loss carryforwards of \$727,000 and \$306,000, respectively, available to offset future taxable income. The carryforwards generally expire through 2012 and may be subject to annual limitations as a result of changes in the Company's ownership. There can be no assurances that changes in ownership in future periods or any future losses will not significantly limit the Company's use of the net operating loss carryforwards. In addition, no valuation allowance for its deferred tax assets, amounting to approximately \$258,000 at December 31, 1997, has been provided for since, in the opinion of management, realization of the future benefit is probable. In making this determination, management considered all available evidence, both positive and negative, as well as the weight and importance given to such evidence.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 1998, the Company had working capital of \$12.0 million, as compared to \$3.4 million as of December 31, 1997. Operating activities provided net cash of \$5.1 million in 1998 as compared to having used net cash of \$0.4 million in 1997. In 1998, net cash was provided primarily by net income and non-cash charges. At September 30, 1998, the Company had cash and cash equivalents of \$6.6 million.

The Company's investing activities have used net cash of \$4.0 million in 1998, as compared to \$9.7 million in 1997, consisting primarily of the purchase of molds and tooling used in the manufacture of the Company's products and the investment in a joint venture. In 1997, the Company's investing activities used cash principally for the purchase of Road Champs including goodwill, trademarks and molds and tooling, as well as molds and tooling used in the manufacture of the Company's products. As part of the Company's strategy to develop and market new products, the Company has entered into various character and product licenses with royalties of 1% to 10% payable on net sales of such products. As of September 30, 1998, these agreements require future aggregate minimum guarantees of \$14.6 million, exclusive of \$1.6 million in advances already paid this year.

The Company's financing activities have provided net cash of \$3.0 million in 1998, consisting primarily of the issuance of 1,000 shares of its 7% Series A Cumulative Convertible Preferred Stock at a price of \$5,000 per share in connection with a private placement to two investors partially offset by the repayment of various debt issued in connection with the Road Champs and Child Guidance/Remco trademarks acquisitions.

In January 1997, the Company received net proceeds of approximately \$5.5 million, net of issuance costs, from the issuance of \$6.0 million in convertible debentures which are convertible into 1,043,478 shares of Common Stock at a conversion price of \$5.75 per share, subject to anti-dilution provisions. Such debentures bear interest at 9% per annum, payable monthly, and are due in December 2003.

In February 1997, the Company acquired Road Champs for approximately \$11.7 million. Consideration paid at closing was approximately \$4.7 million in cash plus the issuance of \$1.5 million (198,020 shares) of Common Stock. The balance of the cash consideration (\$5.5 million) was payable during the twelve-month period ending in February 1998. This acquisition provided the Company with immediate significant growth in the mini vehicle product category with Road Champs product line of die cast collectible and toy vehicles. Assets included in the purchase were molds and tooling, office and warehouse equipment and other operating assets, as well as license agreements, trade name and goodwill.

In October 1997, the Company acquired the Child Guidance and Remco trademarks for approximately \$13.4 million. Consideration paid at closing was \$10.6 million in cash plus the issuance of a note payable in the amount of \$1.2 million, which is payable in five quarterly installments ending December 31, 1998 and bears interest at 10% per annum. In addition, the Company incurred legal and accounting fees of approximately \$0.3 million and reserves of \$1.3 million. This acquisition provided the Company with immediate expanded growth in the toy vehicle category, which complements the collectible and toy nature of the Road Champs line. In addition, Child Guidance enabled the Company to enter the pre-school toy category with a quality name. The acquisition was funded in part by the issuance of the Company's 4% convertible preferred stock, which were converted to the Company's common

stock on March 30, 1998. Also in connection with this acquisition, the Company entered into a manufacturing and supply agreement whereby the seller of the trademarks will provide the tools and other manufacturing resources for the production of products under the trademarks. Such agreement provides for payments to the seller of four quarterly payments of \$110,000 followed by six quarterly payments of \$160,000, which commenced on December 31, 1997.

In October, 1997, the Company entered into a credit facility agreement with Norwest Bank Minnesota, N.A. which provides the Company's Hong Kong subsidiaries with a working capital line of credit and letters of credit for the purchase of products and the operation of the subsidiaries. The facility has an overall limit of \$5.0 million, but is subject to other limitations based on advance rates on letters of credit and open accounts receivable. As of September 30, 1998, there were no outstanding advances under the facility.

On April 1, 1998, the Company received approximately \$4.8 million in net proceeds from the issuance of shares of its 7% Series A Cumulative Convertible Preferred Stock to two investors in a private placement, which are convertible into 558,658 shares of the Company's Common Stock at a conversion price of \$8.95 per share. The use of proceeds is for working capital and general corporate purposes.

The Company believes that its cash flow from operations, cash on hand and the net proceeds from the issuance of the 7% Series A Cumulative Convertible Preferred Stock, together with the availability on the Norwest facility, will be sufficient to meet working capital and capital expenditure requirements and provide the Company with adequate liquidity to meet its anticipated operating needs for the foreseeable future. Although operating activities are expected to provide cash, to the extent the Company grows significantly in the future, its operating and investing activities may use cash and, consequently, such growth may require the Company to obtain additional sources of financing. There can be no assurance that any necessary additional financing will be available to the Company on commercially reasonable terms, if at all.

YEAR 2000 PROJECT

Many computer systems process dates in application software and data files based on two digits for the year of a transaction rather than a full four digits. These systems are unable to properly process dates in the year 2000. The Company has developed plans to address the impact of replacing or modifying its key financial informational and operational systems to deal with this issue. Several new information technologies have been and are being installed to achieve further productivity and cost improvements. These systems will be year 2000 compliant. The Company believes that all systems necessary to manage the business effectively will be replaced, modified or upgraded before the year 2000. Because of the system replacement and business reengineering expenditures currently underway, the Company believes the costs to modify current systems to be year 2000 compliant will not be significant to the Company's financial results.

PART II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

(c) Recent Sales of Unregistered Securities

Pursuant to its Second Amended and Restated 1995 Stock Option Plan, non-employee directors of the Company received automatic quarterly grants of options to purchase an aggregate amount of 18,750 shares at a purchase price of \$12.00 per share.

Exemption from registration under the Securities Act is claimed for the sale of all of the securities set forth above in reliance upon the exemption afforded by Section 4(2) of the Securities Act for transactions not involving a public offering.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

| NUMBER - - - - - | DESCRIPTION - - - - - |
|---------------------|--|
| 3.1 | Restated Certificate of Incorporation of the Company(1) |
| 3.1.1 | Certificate of Designation and Preferences of Series A Cumulative Convertible Preferred Stock of the Company(2) |
| 3.1.2 | Certificate of Elimination of All Shares of 4% Redeemable Convertible Preferred Stock of the Company(2) |
| 3.2.1 | By-Laws of the Company(1) |
| 3.2.2 | Amendment to By-Laws of the Company(3) |
| 4.1 | JAKKS Pacific, Inc. 9.00% Convertible Debenture issued to Renaissance Capital Growth & Income Fund III, Inc., dated December 31, 1996(3) |
| 4.2 | JAKKS Pacific, Inc. 9.00% Convertible Debenture Issued To Renaissance US Growth & Income Trust PLC, Dated December 31, 1996(3) |
| 10.1 | Supplemental lease dated August 10, 1998 between Malibu Vista Partners and the Company(4) |
| 10.2 | Office lease dated September 24, 1998 between Astoria Investment Company Limited and Road Champs Limited(4) |
| 27 | Financial Data Schedule(4) |

(1) Filed previously as an exhibit to the Company's Registration Statement on Form SB-2 (File No. 333-2048-LA), effective May 1, 1996, and incorporated herein by reference.

(2) Filed previously as an exhibit to the Company's Current Report on Form 8-K, filed April 7, 1998, and incorporated herein by reference.

(3) Filed previously as an exhibit to the Company's Registration Statement on Form SB-2 (File No. 333-22583), effective May 1, 1997, and incorporated herein by reference.

(4) Filed herewith.

(b) Reports on Form 8-K

No Current Report on Form 8-K was filed in the fiscal quarter ended September 30, 1998.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Registrant:

JAKKS PACIFIC, INC.

Date: November 16, 1998

By: /s/ Jack Friedman

Chairman
(Principal Executive Officer)

Date: November 16, 1998

By: /s/ Joel M. Bennett

Chief Financial Officer
(Principal Financial and
Accounting Officer)

SUPPLEMENTAL LEASE DATED AUGUST 10, 1998

This Supplemental Lease is made this 10th Day of August, by and between Malibu Vista Partners, a California general partnership, herein called "Lessor," and JAKKS Pacific, Inc., herein called "Lessee."

RECITALS

- A. By Lease dated June 18, 1997, Lessor leased to Lessee Suite 226 located on the second floor in Lessor's office building located at 22761 Pacific Coast Highway, Malibu, California.
- B. Lessee now desires to add Suite 280, consisting of 2,141 rentable square feet to its existing premises.

AGREEMENT

NOW, THEREFORE, the parties agree as follows:

- 1. The Supplemental Lease term shall end on August 31, 2002, the same expiration date of the original Lease.
- 2. Lessor shall deliver possession of Suite 280 to Lessee upon the execution of this Supplemental Lease.
- 3. The base rent for Suite 280 shall be \$4,817.25 and shall commence on October 1, 1998, provided tenant improvements referred to in Section 6 are completed by such date. The commencement shall be delayed one day for each day after October 1, 1998 such improvements are not completed.
- 4. Upon the execution of this Supplemental Lease, Lessee shall pay Lessor the sum of \$9,634.50, constituting rent for October 1998, in the amount of \$4,817.25 and a security deposit in the amount of \$4,817.25, which will be held by Lessor pursuant to the terms of Paragraph 5 of the original Lease.
- 5. In addition to rent, Lessee shall pay to Lessor its proportionate share of building expenses, which shall be calculated on 2,141 rentable square feet.
- 6. Lessor shall, at Lessor's sole expense, provide the tenant improvements shown on the attached tenant improvement space plan ("Plan"). Both Lessor and Lessee shall initial the Plan to indicate their approval.
- 7. The first annual base year rent increase for Suite 280, as provided in section 1.7 of the Lease, shall become effective September 1, 1999, and shall continue thereafter on each September 1.
- 8. Lessor is currently obtaining entitlements to build an approximately 10,400 rentable square foot, three story office building on the adjoining lot located at 22751 Pacific Coast Highway. Lessee is hereby granted an option to lease any one or more of the entire floors of 22751 Pacific coast Highway under the following terms and conditions:

- (a) At any time after the commencement of construction, Lessor shall notify Lessee in writing of the approximate anticipated completion date and the rent for each of the floors, which shall not exceed \$3.00 per rentable square foot. If Lessee, within 60 days after receipt of Lessor's notice, indicates in writing its agreement to lease one or more floors (the "New Space") for a term of 5 years or more, the parties shall enter into a lease in the form of the existing original Lease for the space, which shall include the same annual rent adjustment provision as is contained in the original Lease.
- (b) The Lease for the New Space shall require a security deposit equal to one month's rent.
- (c) Lessee shall receive a \$40 per rentable square foot tenant improvement allowance.
- (d) Rent shall commence upon the delivery of possession of the New Space after substantial completion of the tenant improvements.
- (e) Lessee shall have the option by 30 days' written notice to Lessor to terminate its original Lease and/or this Supplemental Lease effective at any time after accepting possession of the New Space, provided, that the square footage of the New Space is equal to or greater than the square footage of the terminated space.

Except as modified herein, all other terms and conditions of the Lease dated June 18, 1997, are incorporated herein and shall become a part of this Supplemental Lease as though fully set forth herein.

LANDLORD

LANDLORD:
Malibu Vista Partners

TENANT:
JAKKS Pacific, Inc.

By: /s/ Gil Peled

Gil Peled, Partner
Date: August 18, 1998

By: /s/ Stephen G. Berman

Stephen Berman, President
Date: August 18, 1998

THIS AGREEMENT made the 24th day of September, One thousand
nine hundred and ninety-eight

BETWEEN

ASTORIA INVESTMENT COMPANY LIMITED whose registered office is situate at Room
2703, Wing on House, 71 Des Voeux Road, Central, Hong Kong (hereinafter called
"the Landlord") of the one part and

ROAD CHAMPS LIMITED whose registered office is situate at Units 1008-9, 10/F.,
Peninsula Centre, 67 Mody Road, Tsimshatsui East, Kowloon, Hong Kong
(hereinafter called "the Tenant") of the other part.

WHEREBY IT IS AGREED by and between the parties hereto as follows: -

1. The Landlord hereby lets to the Tenant and the Tenant takes from
the Landlord the premises known as Unit 1014 on 10th Floor, Peninsula Centre,
No. 67 Mody Road, Kowloon, Hong Kong (hereinafter called "the said premises")
Together with the right in common with the Landlord and others having the like
right to use go pass and repass up down over and upon the common parts including
inter alia entrance passages halls staircases and lifts so far as the same are
necessary for the proper enjoyment of the said premises subject to the term and
conditions hereinafter contained TO HOLD the same unto the Tenant for the term
of ONE YEAR SIX MONTHS AND FOURTEEN DAYS commencing from the 1st day of
September 1998 and expiring on the 14th day of March 2000 at a rent of HONG KONG
DOLLARS THIRTY-THREE THOUSAND AND EIGHTY-TWO ONLY (HK\$33,082.00) Hong Kong
Currency per calendar month payable in advance on the 1st day of each and every
calendar month without deduction Provided Further that the last of such payment
shall be made pro-rate according to the number of days then unexpired in the
month on which such payment is made.

2. It is hereby agreed and declared that the said premises are let
for the use of an office by the Tenant only.

3. The tenant hereby agrees with the Landlord as follows: -

- (a) To pay the said rent at the times and in the manner aforesaid.
- (b) To pay and discharge all rates taxes assessments duties charges
impositions and other outgoings now or at any time hereafter to
be imposed or charged by the Government of Hong Kong or other
lawful authority in respect of the said premises upon the owner
or occupier in respect thereof (Government Rent, Property Tax
and all other outgoings of a capital or non-recurring nature
excepted).
- (c) To pay all charges for electricity, water and gas consumed by
the Tenant in the said premises and all service, maintenance
charges and management fees

payable in respect of the said premises, including the deposits for the meters therefor.

- (d) To well and sufficiently paint maintain and keep in good repair and condition the interior of the said premises, the furniture and fittings (if any) and all the Landlord's fixtures and additions thereto (fair wear and tear expected). In particular, the Tenant will at its own expense replace any broken or damaged window panes, fancoils, pipes, wires, drains, taps, wash-basins and cisterns on the said premises save and except damaged caused by the agent or servant of the Landlord.
- (e) To take all diligent precautions and due care to protect the interior of the said premises against damage by fire storm typhoon or the like.
- (f) To permit the Landlord and its agents with or without workmen or others at all reasonable times and upon reasonable notice being given to the Tenant to enter upon the said premises and to view the condition thereof and upon notice being given by the Landlord forthwith to repair in accordance therewith. Upon the Tenant failing to comply with the said notice the Landlord or its agents shall be entitled with or without workmen or others at all reasonable times and upon reasonable notice being given to the Tenant to enter upon the said premises to carry out any repair and the Tenant shall be liable to pay the Landlord's cost of carrying out any such repair and incidental charges provided that in the event of any emergency the Landlord its servants or agents may enter without notice and forcibly if necessary, provided that the Landlord shall keep the Tenant indemnified for any loss and damages caused by the negligence of the Landlord or its agents in gaining such entry.
- (g) Not without the previous written consent of the Landlord (which consent shall not be unreasonably withheld or delayed) to erect install or alter any fixtures partitioning or other erection or installation in the said premises or any part thereof or without the like consent to make or permit or suffer to be made alterations in or additions to the electrical/gas wiring/piping and installations or to install or permit or suffer to be installed any equipment apparatus or machinery which imposes a weight on any part of the flooring in excess of that for which it is designed or which requires any additional electrical/gas main wiring/piping or which consumes electricity/gas not metered through the Tenant's separate meter. The Landlord shall be entitled to prescribe the maximum weight and permitted locations of safes and other heavy equipment and to require that the same stand on supports of such dimensions and material to distribute the weight as the Landlord may deem necessary.
- (h) Not to transfer assign underlet or otherwise part with the possession of the said premises or any part thereof either by way of subletting lending sharing or other means whereby any person or persons not party to this Agreement obtains the use or possession of the said premises or any part thereof irrespective of whether any rental or other consideration is given for such use or possession and in the event of any such transfer subletting sharing assignment or parting with the possession of the said premises (whether for monetary consideration or not) this Agreement shall at the discretion of the Landlord determine and the Tenant shall forthwith surrender the said premises to the Landlord. The tenancy shall be

personal to the Tenant named in this Agreement and without in any way limiting the generality of the foregoing, the following acts and events shall, unless previously approved in writing by the Landlord (which approval the Landlord shall not be unreasonably withheld) be deemed to be breaches of this subclause: -

- (1) in the case of a Tenant which is a partnership, the taking in of one or more new partners whether on the death or retirement of an existing partner or otherwise.
 - (2) in the case of a tenant who is an individual (including a sole surviving partner of a partnership tenant) the death, insanity or other disability of that individual to the intent that no right to use, possess, occupy or enjoy the said premises or any part thereof shall vest in the executors, administrators, personal representatives, next of kin, trustee or committee of any such individual.
 - (3) in the case of a tenant which is a corporation any take-over reconstruction, amalgamation, merger, voluntary liquidation or change in the person or persons who owns or own a majority of its voting shares or who otherwise has or have effective control thereof.
 - (4) the giving by the Tenant of a Power of Attorney or similar authority whereby the donee of the Power obtains the right to use, possess, occupy or enjoy the said premises or any part thereof or does in fact use, occupy or enjoy the same.
 - (5) the change of the Tenant's business name without the previous written consent of the Landlord which consent shall not be withheld or delayed.
- (i) Not to do or permit or suffer to be done in or upon the said premises or any part thereof any act or thing which may be or become or cause a nuisance annoyance damage or disturbance to the Landlord or to any of the tenants or occupiers of the other parts of the said building or of the neighboring premises or which shall amount to a breach or non-observance of any of the covenants and conditions contained in the Government Lease of the said premises, the Occupation Permit and the Deed of Mutual Covenant or which shall be in anywise against the laws of regulations of the Government of Hong Kong.
 - (j) Not to keep or store or cause or permit or suffer to be kept or stored any arms, ammunition, gunpowder, salt-petre, or other explosive or inflammable substance in the said premises.
 - (k) Not to use or permit or suffer to be used the said premises or any part thereof for any illegal or immoral purposes.
 - (l) To observe and comply with all house rules and regulations made by the appropriate management authorities relating to the use and management of the common parts of the said building.
 - (m) Not to do or permit or suffer to be done anything in or upon the said building and the said premises which may infringe any laws, regulations, bye-laws and rules and all notices and requirements of the Governmental Departments and other competent authorities in connection with or in relation to the use and occupation of the said premises and the said building.

- (n) Not to do or cause or permit or suffer to be done anything whereby the policy or policies of insurance on the said premises and/or the said building against damage by fire or against other damages howsoever caused may be rendered void or voidable or whereby the premium for such insurance may be liable to be increased and the Tenant shall indemnify the Landlord against such increased or additional premium as shall have been brought about or caused by its act or default.
- (o) Not to obstruct or permit any employee or agent to obstruct any passageway lift staircase entrance exit or other common parts of the said building, and it is hereby expressly agreed that if any such obstruction shall happen and the Tenant shall fail to remove the same immediately upon request either to the Tenant or to the person then in charge of the said premises on the Tenant's behalf, the Landlord shall be entitled to dispose of the same in whatever manner the Landlord shall deem fit including inter alia destroying and disposing of the same as rubbish and selling the same on such terms and conditions as the Landlord may deem fit.
- (p) Not to use the verandah of the said premises for the purpose of drying or hanging any clothing and not to exhibit or display anything on or near the verandah of the said premises or any part thereof in such a manner which will affect the appearance of the said building.
- (q) Not to erect or permit to be erected outside the said premises any wireless or television aerial nor do to permit to be done anything to the external walls of the said premises which will affect the appearance of the said building.
- (r) Not to place or allow to be placed any showboard name-bill placard advertisement or notice of any description upon the external walls and the windows of the said premises.
- (s) Not to keep in the said premises any animal or domestic pet without the prior consent of the Landlord.
- (t) To pay and make good to the Landlord all and every loss and damage whatsoever incurred or sustained by the Landlord as a consequence of every breach or non-observance of the Tenant's obligations and stipulations herein contained and to indemnify the Landlord from and against all actions claims liability costs and expenses thereby arising.
- (u) At the expiration or sooner determination of this Agreement to deliver up to the Landlord the said premises in particular the furniture and fittings (if any) in good clean and tenantable repair and condition (fair wear and tear excepted) as aforesaid together with any additional erections alterations or improvements which the Tenant may with the consent of the Landlord as aforesaid have made upon or in the said premises without payment of any compensation for such additional erections alterations or improvements.
- (v) To allow at all reasonable times by appointment within three calendar months immediately preceding the expiration of the said term prospective Tenants or occupiers to inspect the said premises.

4. The Landlord hereby agrees with the Tenant as follows: -

- (a) That the Tenant paying the rent hereby reserved and performing and observing the terms and conditions herein contained and on the part of the Tenant to be performed and observed may peaceably hold and enjoy the said premises during the said term without any interruption by the Landlord or any person lawfully claiming through or under it.
- (b) To pay Government rent, property tax and all outgoings of a capital or non-recurring nature which are now or may hereafter during the said term be imposed by the Government upon the said premises.
- (c) To use its best endeavor at the Landlord's expense to procure the manager of the said building to maintain the main walls, main drains and main pipes, main structures, roof, lifts, electricity cables and all common areas and facilities of the said building and/or the said premises in good and substantial repair and condition throughout the said term.

5. PROVIDED ALWAYS AND IT IS HEREBY EXPRESSLY AGREED AND DECLARED as follows: -

- (a) If the rent reserved or any part thereof shall be unpaid for seven (7) days after becoming payable (whether legally or formally demanded or not) or if the Tenant shall fail or neglect to perform or observe any term or condition herein contained and on the Tenant's part to be performed or observed or if the Tenant shall become bankrupt or in the case of a limited company shall go into liquidation or if a petition for the Tenant's bankruptcy or winding up, as the case may be, shall have been filed or if the Tenant shall enter into any composition or arrangement with creditors or shall suffer the Tenant's goods or other property to be levied on execution then and in any of the said cases it shall be lawful for the Landlord at any time thereafter to determine this Agreement and to re-enter the said premises or any part thereof in the name of the whole but without prejudice to any right of action of the Landlord in respect of any breach of the Tenant's terms and conditions herein contained and the deposit paid hereunder shall be forfeited to the Landlord but without prejudice to the Landlord's right to claim any further damages which the Landlord shall have sustained or may sustain and a written notice served by the Landlord on the Tenant to the effect that the Landlord thereby exercises the power of re-entry and determination hereinbefore contained shall be a full and sufficient exercise of such power.
- (b) In the event of any breach of any term or condition on the part of the Tenant herein contained, the Landlord shall not by acceptance of rent or by any other act whatsoever or by any omission be deemed to have waived any such breach of term or condition notwithstanding any rule of law or equity to the contrary and that no consent to or waiver of any breach shall be binding on the Landlord unless the same is in writing of the Landlord. Notwithstanding anything hereinbefore contained in the event of default in payment by the Tenant in respect of any payments to be made hereunder for a period of seven days from the date on which the same falls due for payment, the Tenant shall further pay to the Landlord on demand interest on the amount in arrears at the rate of 1.5 per cent (1.5)% per

month calculated from the date on which the same becomes due for payment until the date of payment as liquidated damages and not as penalty provided that the demand and/or receipt by the Landlord of interest pursuant to this provision shall be without prejudice to and shall not affect the right of the Landlord to exercise any other right or remedy hereof (including the right of re-entry) exercisable under the terms of this Agreement.

- (c) For the purpose of this Agreement any act default neglect or omission of any servant, agent, licensee, visitor and invitee of the Tenant shall be deemed to be the act default neglect or omission of the Tenant.
- (d) In the event of the said premises or any part thereof at any time during the said term being damaged or destroyed by acts of war fire typhoon earthquake flood white ants or subsidence of the soil so as to render the same unfit for occupation and use and the cause of which is not attributable to the acts or omission of the Tenant then the rent hereby reserved or a fair proportion thereof according to the nature and extent of the damage sustained shall cease to be payable until the said premises shall have been again rendered fit for occupation and use PROVIDED ALWAYS that should the whole of the said premises or the greater part thereof be so destroyed or damaged by the happening of any of the above events as to be unfit for use and occupation the Landlord shall not be required to rebuild or reinstate the said premises or the said building if by reason of the condition of the same or any local Regulations or other circumstances beyond the control of the Landlord it is not practicable or reasonable to do so Provided that if the Landlord shall fail to reinstate or cause to be reinstated the said premises or the said building within six months of receiving a written notice to reinstate the same from the Tenant or if the said premises or the greater part thereof or the said building remain uninhabitable or inaccessible for a period of one month the Tenant may forthwith or within a reasonable time thereafter by a written notice terminate this Agreement and thereupon the same and everything herein contained shall be void as from the date of occurrence of such damage or destruction and the Landlord shall forthwith refund to the Tenant the said deposit or the balance thereof but without prejudice to the rights and remedies of either party against the other in respect of any antecedent claim or breach or covenant.
- (e) Any notice required to be served hereunder shall be sufficiently served on the Tenant if delivered or sent by post or left addressed to it at the said premises or at its registered office in Hong Kong and any notice to the Landlord shall be sufficiently served if sent to the Landlord by post at the Landlord's registered office in Hong Kong. A notice sent by post shall be deemed to have been received at the time when in due course of post it would be delivered at the address to which it is sent.
- (f) For the purpose of distress for rent in terms of Part III of the Landlord and Tenant (Consolidation) Ordinance (Cap. 7) and for the purpose of this Agreement the rent in respect of the said premises shall be deemed to be in arrears if not paid in advance at the time and in the manner hereinbefore provided for payment thereof.

- (g) The Tenant shall not be entitled to any compensation or abatement of rent in respect of any failure howsoever caused in respect of the lifts, electricity supply or other services provided to the said building.
- (h) The Landlord does not warrant that the light and air to the premises would not be obstructed.
- (i) The Landlord shall not be in any way liable to the Tenant or to any person or persons claiming any right title or interest under the Tenant or any person expressly or impliedly authorized by the Tenant to enter leave or remain on the said building or any part thereof for any damage to property or injury to person which may be sustained by the Tenant or any such person or persons as aforesaid on account of the defective or damaged condition of the said premises the said building and the Landlord's fixtures or fittings therein and any part thereof and in particular the Landlord shall not be responsible to the Tenant or any person or persons as aforesaid for any damage to property or injury to person caused by or through or in any way owing to the overflow of water or water leakage from any floor flat or premises or any part of the said building any typhoon electric current water pipes electric wiring or cables situated upon under or in any way connected with the said premises and/or the said building or dropping of cigarette ends broken pieces of glass or other articles from any floor flat premises or any part of the said building or neighborhood and the Tenant hereby agrees to indemnify the Landlord against all claims demands actions costs expenses whatsoever made upon the Landlord by any person or persons in respect of the matters aforesaid and further the Tenant shall be responsible for any damage which may be done to any part of the said premises or to the Landlord's fixtures and fittings therein.

- 6. (a) The Tenant shall on or before the signing hereof deposit with the Landlord the sum specified in the Schedule hereto to secure the due observance and performance by the Tenant of the agreements stipulations and conditions herein contained and on the Tenant's part to be observed and performed. The said deposit shall be retained by the Landlord throughout the said term free of any interest to the Tenant and in the event of any breach or non-observance or non-performance by the Tenant or any of the agreements stipulations or conditions aforesaid the Landlord shall be entitled to terminate this Agreement in which event the said deposit may be forfeited to the Landlord without prejudice to the Landlord's right of action to claim for any monetary loss or damage which the Landlord may sustain by reasons of the aforesaid breach non-observance or non-performance. Notwithstanding the foregoing the Landlord may in any such event at its option elect not to terminate this Agreement but to deduct from the deposit the amount of any monetary loss incurred by the Landlord in consequence of the breach non-observance or non-performance by the Tenant in which event the Tenant shall as a condition precedent to the continuation of the tenancy deposit with the Landlord the amount so deducted and if the Tenant shall fail so to do the Landlord shall forthwith be entitled to re-enter on the said premises or any part thereof in the name of the whole and to determine this Agreement in which event the deposit may be forfeited to the Landlord as hereinbefore provided.

- (b) Subject as aforesaid the said deposit shall be refunded to the Tenant by the Landlord without interest within thirty days after the expiration or sooner determination of this Agreement and delivery of vacant possession to the Landlord against the Tenant for any arrears of rent rates and other charges and for any breach non-observance or non-performance of any of the covenants agreements stipulations terms and conditions herein contained and on the part of the Tenant to be observed or performed whichever shall be the later.

7. It is hereby expressly declared that no key or construction money or other premium of a similar nature has been paid by the Tenant or any person or persons for and on behalf of the Tenant to the Landlord or any other person for the grant of this tenancy.

8. Where more that one person is party hereto as Landlord or Tenant, the expression "the Landlord" and "the Tenant" shall where the context admits include all either or any of such persons and their liability contained or implied herein shall be joint and several.

9. In this Agreement unless inconsistent with the context, words denoting persons include corporations and firms; words denoting masculine gender include feminine gender and neuter gender; and words denoting the singular number include the plural number and vice versa.

10. Each party shall bear his own solicitors' costs charges and expenses of and incidental to this Agreement and the stamp duty (including the counterpart) and registration fee, if any, on this agreement shall be borne equally by the parties hereto.

11. Notwithstanding anything herein contained, the Landlord hereby agrees to grant a rent free period to the Tenant from 1st September 1998 to 7th October 1998 for decoration purpose only. The management fee, air-conditioning charges, government rates and all outgoings payable in respect of the said premises for the said rent-free period shall be borne and paid by the Tenant solely.

12. (a) The Tenant shall have an option to renew the tenancy of the Premises and Rooms 1008-9 by giving to the Landlord 6 months prior written notice before the expiration of the term hereby granted of its desire to renew this Agreement of the Premises and the respective agreement of Rooms 1008-9 and provided at the date of service of notice there should be no subsisting breach or breaches on the part of the Tenant to be observed and performed and also the Tenant shall have performed and observed the several covenants hereinbefore contained on its part to be observed and performed up to the expiration of the term hereby granted the Landlord shall let the Premises for a further term of 1 (One) year from the expiration of the term hereby granted.

- (b) The tenancy shall be renewed on the same terms and conditions as this Agreement (save and except this Clause 12 and the rent free period (if any)) and the monthly rent for the Premises shall be the same as stated in Clause 1 of this Agreement and HK\$54,468.00 (Hong Kong Dollars Fifty Four Thousand Four Hundred and Sixty-Eight)for Rooms 1008-9.

- (c) The rights granted by this Clause are personal to the Tenant alone and may only be exercised by it.
- (d) If the Tenant shall fail to exercise the option to renew on the terms and conditions aforesaid or be in breach of the terms and conditions aforesaid or if the Tenant shall vacate or deserted the Premises during the tenancy without the consent of the Landlord, this option shall be null and void and the Landlord shall be at liberty to deal with or otherwise dispose of the Premises in such manner as it thinks fit.

AS WITNESS the hands of the parties hereto the day and year first above written.

The deposits in the sum of HK\$118,284.00 the breakdown of which are as follows: -

| | | |
|-----|---|-------------------------|
| (a) | Rental deposit | HK\$ 99,246.00 |
| (b) | Management fee and air-conditioning charges deposit | HK\$ 19,038.00 ----- |
| | | HK\$118,284.00 ----- |

SIGNED by Mr. Lauw Siang Liong) /s/ Lauw Siang Liong
)
for and on behalf of the Landlord in the)
)
presence of: /s/ Amy Keung)

SIGNED by Stephen G. Berman) /s/ Stephen G. Berman
)
for and on behalf of the Tenant in the)
)
presence of: /s/ Vincent Kwok)

RECEIVED the day and year first above written)
 of and from the Tenant HONG KONG DOLLARS ONE HUNDRED)
 EIGHTEEN THOUSAND TWO HUNDRED AND EIGHTY FOUR)
 ONLY being the rental deposits, management fee)
 & air-conditioning charges deposits above expressed to be paid by)
 the Tenant to the Landlord in respect of the said premises)

HK\$118,284.00

/s/ Lauw Siang Liong

the Landlord

9-MOS

DEC-31-1998
JAN-01-1998
SEP-30-1998

| | |
|------------|------------|
| | 6,601,170 |
| | 0 |
| 18,775,495 | 0 |
| | 3,030,416 |
| 30,327,955 | 6,453,644 |
| | 2,308,061 |
| 60,435,362 | 60,435,362 |
| 18,364,985 | 6,000,000 |
| | 0 |
| | 1 |
| | 5,937 |
| 60,435,362 | 35,977,543 |
| | 61,379,402 |
| 61,379,402 | 37,669,477 |
| | 37,669,477 |
| 16,447,200 | 0 |
| | 0 |
| 467,638 | 0 |
| 6,574,166 | 0 |
| 1,720,069 | 0 |
| 4,854,097 | 0 |
| | 0 |
| | 0 |
| | 0 |
| 4,854,097 | 0 |
| | 0.87 |
| | 0.68 |