

REGISTRATION NO. 333-

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM S-1  
REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933

SKECHERS U.S.A., INC.  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

<TABLE>		
<S>	<C>	<C>
DELAWARE	5139	95-4376145
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(PRIMARY STANDARD INDUSTRIAL CLASSIFICATION CODE NUMBER)	(I.R.S. EMPLOYER IDENTIFICATION NUMBER)
</TABLE>		

228 MANHATTAN BEACH BOULEVARD  
MANHATTAN BEACH, CALIFORNIA 90266  
(310) 318-3100  
(ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

ROBERT GREENBERG  
CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER  
MICHAEL GREENBERG  
PRESIDENT  
SKECHERS U.S.A., INC.  
228 MANHATTAN BEACH BOULEVARD  
MANHATTAN BEACH, CALIFORNIA 90266  
(310) 318-3100  
(NAME, ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF AGENTS FOR SERVICE)

COPIES TO:

<TABLE>	
<S>	<C>
THOMAS J. POLETTI, ESQ.	BARRY E. TAYLOR, ESQ.
SUSAN B. KALMAN, ESQ.	CRAIG D. NORRIS, ESQ.
KATHERINE J. BLAIR, ESQ.	ANNA ITOI, ESQ.
FRESHMAN, MARANTZ, ORLANSKI, COOPER & KLEIN	WILSON SONSINI GOODRICH & ROSATI,
9100 WILSHIRE BOULEVARD, SUITE 8E	PROFESSIONAL CORPORATION
BEVERLY HILLS, CALIFORNIA 90212	650 PAGE MILL ROAD
TELEPHONE (310) 273-1870	PALO ALTO, CALIFORNIA 94304
FACSIMILE (310) 274-8357	TELEPHONE (650) 493-9300
	FACSIMILE (650) 493-6811
</TABLE>	

APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC:  
As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box: [ ]

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering. [ ]

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act

registration statement number of the earlier effective registration statement for the same offering. [ ]

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. [ ]

CALCULATION OF REGISTRATION FEE

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TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	PROPOSED MAXIMUM PRICE(1)	AGGREGATE OFFERING REGISTRATION FEE	AMOUNT OF
Common Stock, \$.001 par value.....	\$115,057,500	\$33,942	

</TABLE>

(1) Estimated solely for the purpose of calculating the registration fee in accordance with Rule 457(o) under the Securities Act of 1933.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933, AS AMENDED, OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

INFORMATION CONTAINED HEREIN IS SUBJECT TO COMPLETION OR AMENDMENT. A REGISTRATION STATEMENT RELATING TO THESE SECURITIES HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION. THESE SECURITIES MAY NOT BE SOLD NOR MAY OFFERS TO BUY BE ACCEPTED PRIOR TO THE TIME THE REGISTRATION STATEMENT BECOMES EFFECTIVE. THIS PROSPECTUS SHALL NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY NOR SHALL THERE BE ANY SALE OF THESE SECURITIES IN ANY STATE IN WHICH SUCH OFFER, SOLICITATION OR SALE WOULD BE UNLAWFUL PRIOR TO REGISTRATION OR QUALIFICATION UNDER THE SECURITIES LAWS OF ANY SUCH STATE.

SUBJECT TO COMPLETION  
JULY 29, 1998

Shares  
SKECHERS U.S.A., INC.  
[LOGO]  
Common Stock

All of the shares of common stock, par value \$.001 per share (the "Common Stock"), offered hereby (the "Offering") are being sold by Skechers U.S.A., Inc., a Delaware corporation (the "Company"). Prior to the Offering, there has been no public market for the Common Stock. It is currently anticipated that the initial public offering price will be between \$ and \$ per share. See "Underwriting" for a discussion of factors to be considered in determining the initial public offering price.

The Company intends to apply for listing of the Common Stock on the New York Stock Exchange under the symbol "SKX."

THE OFFERING INVOLVES A HIGH DEGREE OF RISK. SEE "RISK FACTORS" COMMENCING ON PAGE 8.

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THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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	PRICE TO PUBLIC	UNDERWRITING DISCOUNTS AND COMMISSIONS(1)	PROCEEDS TO COMPANY(2)
<S>	<C>	<C>	<C>
Per Share.....	\$	\$	\$
Total(3).....	\$	\$	\$

</TABLE>

- (1) The Company and the principal stockholder of the Company (the "Selling Stockholder") have agreed to indemnify the several Underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended. See "Underwriting."
- (2) Before deducting expenses of the Offering, all of which will be payable by the Company, estimated at \$2,000,000.
- (3) The Selling Stockholder has granted the Underwriters a 30-day option to purchase up to                      additional shares of Common Stock, solely to cover over-allotments, if any. To the extent that the option is exercised, the Underwriters will offer the additional shares at the Price to Public shown above. If the option is exercised in full, the total Price to Public, Underwriting Discounts and Commissions and Proceeds to Selling Stockholder will be \$       , \$        and \$       , respectively. See "Underwriting."

The shares of Common Stock are offered by the several Underwriters, subject to prior sale, when, as and if delivered to and accepted by them, subject to the right of Underwriters to reject any order in whole or in part. It is expected that delivery of the shares of Common Stock will be made at the offices of BT Alex. Brown Incorporated, Baltimore, Maryland, on or about                     , 1998.

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BT ALEX. BROWN                      PRUDENTIAL SECURITIES INCORPORATED

THE DATE OF THIS PROSPECTUS IS                     , 1998

[PICTURES]

CERTAIN PERSONS PARTICIPATING IN THE OFFERING MAY ENGAGE IN TRANSACTIONS THAT STABILIZE, MAINTAIN OR OTHERWISE AFFECT THE PRICE OF THE COMMON STOCK, INCLUDING PURCHASES OF THE COMMON STOCK TO STABILIZE ITS MARKET PRICE, PURCHASES OF THE COMMON STOCK TO COVER SOME OR ALL OF A SHORT POSITION IN THE COMMON STOCK MAINTAINED BY THE UNDERWRITERS AND THE IMPOSITION OF PENALTY BIDS. FOR A DESCRIPTION OF THESE ACTIVITIES, SEE "UNDERWRITING."

in conjunction with, the more detailed information and Financial Statements, including the Notes thereto, appearing elsewhere in this Prospectus. This Prospectus, in addition to historical information, contains forward-looking statements including, but not limited to, statements regarding the Company's plans to increase the number of retail locations and styles of footwear, the maintenance of customer accounts and expansion of business with such accounts, the successful implementation of the Company's strategies, future growth and growth rates and future increases in net sales, expenses, capital expenditures and net earnings. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects," "may," "will," "intends," "estimates" and similar expressions are intended to identify forward-looking statements. These forward-looking statements involve risks and uncertainties, and the Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under "Risk Factors" and elsewhere in this Prospectus.

## THE COMPANY

Skechers U.S.A., Inc. ("Skechers" or the "Company") designs and markets branded contemporary casual, active, rugged and lifestyle footwear for men, women and children. The Company's objective is to become the premier source of contemporary casual and active footwear while ensuring the longevity of both the Company and the Skechers brand name through controlled, well managed growth. The Company strives to achieve this objective by developing and offering a balanced assortment of basic and fashionable merchandise across a wide spectrum of product categories and styles, while maintaining a diversified, low-cost sourcing base and controlling the growth of its distribution channels. The Company sells its products to department stores such as Nordstrom, Macy's, Dillard's, Robinson's-May and JC Penney, and specialty retailers such as Genesco's Journeys and Jarman chains, The Venator Group's Foot Locker and Lady Foot Locker chains, Pacific Sunwear and Florsheim. The Company also sells its products both internationally in over 120 countries and territories through major international distributors and directly to consumers through 26 of its own retail stores.

The Company has realized rapid growth since inception, increasing net sales from \$42.7 million in 1993 to \$183.8 million in 1997. From 1996 to 1997, the Company experienced a 59.3% and 205.1% increase in net sales and earnings from operations, respectively. The Company also experienced an improvement in gross profit as a percentage of net sales from 29.6% to 37.4% and in earnings from operations as a percentage of net sales from 4.4% to 8.5% over this same period, resulting in part from the shift to offering Skechers product exclusively and in part from economies of scale. For the quarter ended March 31, 1998, the Company realized a 117.0% increase in net sales compared to the comparable period from the prior year while increasing gross profit as a percentage of net sales from 33.4% to 37.6%. In 1998, the Company achieved profitability in the first calendar quarter for the first time in its history, a fiscal period which is typically adversely affected by seasonal fluctuations.

Management believes the Skechers product offerings of men's, women's and children's footwear appeal to a broad customer base between the ages of 5 and 40 years. Management believes the Company's strategy of providing a growing and balanced assortment of quality basic footwear and seasonal and fashion footwear with progressive styling at competitive prices gives Skechers this broader based customer appeal. Skechers men's and women's footwear are primarily designed with the active, youthful lifestyle of the 12 to 25 year old age group in mind. The Company's product offerings include casual and utility oxfords, loggers, boots and demi-boots; skate, street and fashion sneakers; hikers, trail runners and joggers; sandals, slides and other open-toe footwear; and dress casual shoes. The Company continually seeks to increase the number of styles offered and the breadth of categories with which the Skechers brand name is identified. This style expansion and category diversification is balanced by the Company's strong performance in its basic styles. The Company increased its styles offered from approximately 390 for the three months ended March 31,

1997 to approximately 600 for the three months ended March 31, 1998. For the three months ended March 31, 1998, approximately 54.0% of the Company's gross sales of men's footwear were generated from basic styles that have been in the Company's line for at least three seasons. Management's goal is to achieve a comparable portion of gross sales of its women's and children's lines in its basic styles with sufficient operating history. The Company's women's and

children's lines have only recently been expanded and emphasized, and many styles within these lines have only recently been introduced.

The Company's strategy in children's footwear is to adapt current fashion from the Company's men's and women's lines by modifying designs and choosing colors and materials that are more suitable to the playful image Skechers has established in the children's footwear market. The Skechers children's line is comprised primarily of shoes that are designed like their adult counterparts but in "takedown" versions, so that the younger set can wear the same popular styles as their older siblings and schoolmates. The playful image of Skechers children's footwear is further enhanced by the Company's Skechers Lights line, which features motion- and contact-activated lights in the outsole and other areas of the shoes. During 1997, the Company's gross footwear sales were derived 60.4% from men's, 27.8% from women's and 11.8% from children's footwear.

The Company was founded in 1992 as a distributor of Dr. Martens footwear. The Company began designing and marketing men's footwear under the Skechers brand name and other brand names including "Cross Colours," "Karl Kani" and "So . . . L.A." in 1992. Shortly after launching these branded footwear lines, the Company discontinued distributing Dr. Martens footwear. In 1995, the Company began to shift its focus to the Skechers brand name by de-emphasizing the sale of "Kani" branded products and discontinuing the sale of "Cross Colours" and "So . . . L.A." branded footwear. In early 1996, the Company substantially increased its product offerings in and marketing focus on its Skechers women's and children's lines. The Company divested the "Karl Kani" license in August 1997. Substantially all of the Company's products are marketed under the Skechers name.

The Company's operating strategies are intended to continue to differentiate the Company from other participants in the footwear market and to provide controlled, well managed growth. These strategies include: (i) offering a breadth of innovative products, (ii) enhancing and broadening the Skechers brand name, (iii) maximizing the strategic value of retail distribution, (iv) controlling the growth of distribution channels and (v) leveraging the experience of the management team and the infrastructure the Company has established. The Company produces over 600 different styles of footwear in a broad array of men's, women's and children's designs in an effort to diversify product risk and increase the potential market available to the Company. In keeping with its strategy, the Company has implemented an extensive marketing campaign to build the Skechers brand name and its association with casual and lifestyle footwear in general, as opposed to any single category of footwear. The Company uses its retail stores to strengthen its brand name image and showcase the range of its product offerings as well as to liquidate close-outs, odd sizes and excess inventory more effectively. Nevertheless, each of the Company's stores that was open for a full quarter made a positive contribution to earnings in 1997. The Company has also made a strategic decision not to open any new accounts through December 31, 1998 in an effort to manage the Company's rapid growth, ensure the integrity of the Skechers brand name and limit markdowns, allowances and returns. Management believes it has the experience and has established the infrastructure of personnel, information systems and distribution capabilities to manage this growth.

In an effort to increase net sales and earnings, the Company has also developed five growth strategies. First, the Company plans to continue to expand its product offerings by developing new styles in existing categories as well as entering categories in which the Company does not currently produce styles. Second, the Company intends to increase penetration of its existing account base by (i) increasing the number of styles carried by existing accounts, (ii) increasing sell-through at the retail level for its existing accounts through increased marketing efforts and (iii) opening new locations with existing accounts. Third, the Company plans to open six new retail locations in the remainder of 1998 and approximately 18 new retail locations in 1999. The Company also plans to launch a mail-order catalog and Internet website distribution in the near future. Fourth, the

Company plans to increase international sales through distribution agreements with partners in countries in which the Company does not currently have distribution. The Company is also exploring selling directly to retailers in certain European countries in which the Company does not currently have distribution and selectively opening flagship retail stores internationally either on its own or through joint ventures. Fifth, the Company is exploring

licensing the Skechers brand name for certain accessories and apparel in a manner and with such partners as management believes will increase earnings and maintain the integrity of the Skechers brand name.

#### THE OFFERING

<TABLE>

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Common Stock offered by the Company..... shares  
Common Stock to be outstanding after the  
Offering(1)..... shares  
Use of Proceeds..... The net proceeds will be used to repay  
indebtedness and to fund the Final Tax  
Distribution and the Final S Corporation  
Distribution. See "Use of Proceeds."  
Proposed New York Stock Exchange Symbol..... "SKX"

</TABLE>

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(1) Excludes options to acquire shares outstanding as of March 31, 1998 at a per share exercise price of \$. Options to purchase an aggregate of shares are expected to be granted to certain employees and non-employee directors of the Company on the effective date of the Offering at an exercise price equal to the initial public offering price. See "Management -- Stock Options."

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The Company's corporate headquarters are located at 228 Manhattan Beach Boulevard, Manhattan Beach, California 90266, and its telephone number is (310) 318-3100.

Skechers, Street Cleat and Wompers are registered trademarks and Fatsoles, Jammers, S Lights and Blasters are trademarks of the Company, and all other trademarks or tradenames referred to in this Prospectus are the property of their respective owners.

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Except as otherwise specified, all information in this Prospectus (i) assumes no exercise of the Underwriters' over-allotment option (see "Underwriting"), (ii) excludes shares of Common Stock reserved for issuance under the Company's 1998 Stock Option, Deferred Stock and Restricted Stock Plan (the "Stock Option Plan") and the Company's 1998 Employee Stock Purchase Plan (the "1998 Purchase Plan") and (iii) gives effect to the reincorporation of the Company in Delaware, which will be effected prior to the consummation of the Offering, whereby the existing California corporation will be merged into a newly formed Delaware corporation and pursuant to which each outstanding share of Common Stock of the existing California corporation will be exchanged for shares of \$.001 par value Common Stock of the new Delaware corporation. Unless the context indicates otherwise, all references herein to the Company refer to Skechers U.S.A., Inc. and its predecessor entity.

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#### SUMMARY FINANCIAL DATA (IN THOUSANDS, EXCEPT PER SHARE DATA)

<TABLE>  
<CAPTION>

	THREE MONTHS ENDED				MARCH 31,		
	YEAR ENDED DECEMBER 31,						
	1993	1994	1995	1996	1997	1997	1998
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
STATEMENT OF OPERATIONS DATA:							
Net sales.....	\$42,725	\$90,755	\$110,649	\$115,410	\$183,827	\$27,591	\$59,873
Cost of sales.....	27,131	61,579	78,692	81,199	115,104	18,384	37,390
Gross profit.....	15,594	29,176	31,957	34,211	68,723	9,207	22,483
Royalty income, net.....	--	1,012	1,843	1,592	894	612	132

	15,594	30,188	33,800	35,803	69,617	9,819	22,615
Operating expenses.....	10,780	26,682	32,000	30,678(1)	53,981	10,118	20,110
Earnings (loss) from operations.....	4,814	3,506	1,800	5,125	15,636	(299)	2,505
Other income (expense):							
Interest.....	(642)	(2,461)	(3,676)	(3,231)	(4,186)	(700)	(1,484)
Other, net.....	(38)	18	214	61	(37)	68	64
	(680)	(2,443)	(3,462)	(3,170)	(4,223)	(632)	(1,420)
Earnings (loss) before income taxes and extraordinary credit.....	4,134	1,063	(1,662)	1,955	11,413	(931)	1,085
Net earnings (loss).....	\$ 4,011	\$ 1,009	\$ (1,222)(2)	\$ 1,910	\$ 11,023	\$ (899)	\$ 1,052
PRO FORMA STATEMENT OF OPERATIONS DATA(3):							
Earnings (loss) before income taxes and extraordinary credit.....	\$ 4,134	\$ 1,063	\$ (1,662)	\$ 1,955	\$ 11,413	\$ (931)	\$ 1,085
Income taxes (benefit).....	1,654	425	(665)	782	4,565	(372)	434
Earnings (loss) before extraordinary credit.....	2,480	638	(997)	1,173	6,848	(559)	651
Extraordinary credit, net.....	--	--	270(2)	--	--	--	--
Net earnings (loss).....	\$ 2,480	\$ 638	\$ (727)	\$ 1,173	\$ 6,848	\$ (559)	\$ 651
Net earnings per share(4):							
Basic.....			\$		\$		
Diluted.....			\$		\$		
Weighted average shares(4):							
Basic.....							
Diluted.....							

</TABLE>

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AS OF MARCH 31, 1998

	AS OF DECEMBER 31, 1997	ACTUAL	PRO FORMA PRO FORMA(5)	AS ADJUSTED(5)(6)
<S>	<C>	<C>	<C>	<C>
BALANCE SHEET DATA:				
Working capital.....	\$17,081	\$17,246	\$13,646	\$ 69,396
Total assets.....	90,881	96,436	96,436	102,281
Total debt.....	39,062	63,746	67,346	2,900
Stockholders' equity.....	11,125	11,874	8,274	78,565

</TABLE>

(1) Operating expenses for 1996 include a \$530,000 charge to operations related to costs of the terminated public offering of the "Kani" division.

(2) Includes an extraordinary gain of \$443,000 net of state income taxes of \$7,000 (\$270,000 on a pro forma basis, net of \$180,000) resulting from the acceleration of the repayment of a note. See Note 12 of Notes to Financial Statements.

(3) Reflects adjustments for Federal and state income taxes as if the Company had been taxed as a C Corporation, at the assumed rate of 40.0%, rather than as an S Corporation.

(4) Weighted average diluted shares outstanding for the three months ended March 31, 1998 include shares issuable upon exercise of stock options outstanding, after applying the treasury stock method based on an assumed initial public offering price of \$ per share (the mid-point of the range). The weighted average diluted shares also give effect to the sale by

the Company of those shares of Common Stock necessary to fund the payment of the excess of (i) the sum of stockholder distributions during the previous 12-month period (during fiscal 1997 for the determination of shares outstanding for fiscal 1997, and during the 15 months ended March 31, 1998 for the determination of shares outstanding for the three month period ended March 31, 1998) and distributions paid or declared thereafter until the consummation of the Offering in excess of (ii) the S Corporation earnings in the previous 12-month period (for the year ended December 31, 1997, and 15 months for the three months ended March 31, 1998), based on an assumed initial public offering price of \$ per share (the mid-point of the range), net of underwriting discounts and estimated Offering expenses. See "Capitalization" and "Management -- Stock Options." For further information pertaining to the calculation of earnings per share, see Note 1 of Notes to Financial Statements.

- (5) Pro forma balance sheet data gives effect to an anticipated \$3.6 million S Corporation distribution to be made in August 1998 consisting of the final installment of income taxes payable on S Corporation earnings for 1997 (the "August Tax Distribution").
- (6) Pro forma as adjusted balance sheet data reflects (i) the Final Tax Distribution estimated to be \$7.0 million and the Final S Corporation Distribution estimated to be \$15.0 million, (ii) the recording by the Company of \$1.3 million of deferred tax assets as if the Company had been a C Corporation since its inception and (iii) the sale of the Common Stock offered by the Company hereby based upon an assumed initial public offering price of \$ per share (the mid-point of the range) and the anticipated application of the net proceeds therefrom. See "Use of Proceeds," "Prior S Corporation Status" and "Capitalization."

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## RISK FACTORS

An investment in the shares of Common Stock offered hereby involves a high degree of risk. Prospective investors should consider carefully the following risk factors, in addition to the other information presented in this Prospectus, before purchasing the shares of Common Stock offered hereby. This Prospectus, in addition to historical information, contains forward-looking statements including, but not limited to, statements regarding the Company's plans to increase the number of retail locations and styles of footwear, the maintenance of customer accounts and expansion of business with such accounts, the successful implementation of the Company's strategies, future growth and growth rates and future increases in net sales, expenses, capital expenditures and net earnings. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects," "may," "will," "intends," "estimates" and similar expressions are intended to identify forward-looking statements. These forward-looking statements involve risks and uncertainties, and the Company's actual results could differ materially from the results discussed in the forward-looking statements. Factors that could cause or contribute to such differences include those discussed below, as well as those discussed elsewhere in this Prospectus.

### CHANGING CONSUMER DEMANDS AND FASHION TRENDS

The footwear industry is subject to rapidly changing consumer demands and fashion trends. The Company believes that its success depends in large part upon its ability to identify and interpret fashion trends and to anticipate and respond to such trends in a timely manner. There can be no assurance that the Company will be able to continue to meet changing consumer demands or to develop successful styles in the future. Decisions with respect to product designs often need to be made several months in advance of the time when consumer acceptance can be determined. As a result, the Company's failure to anticipate, identify or react appropriately to changes in styles and features could lead to, among other things, lower sales, excess inventories, higher inventory markdowns, impairment of the Company's brand image and lower gross margins as a result of allowances and discounts provided to retailers. Conversely, the failure by the Company to anticipate consumer demand could result in inventory shortages, which in turn could adversely affect the timing of shipments to customers, negatively impacting retailer and distributor relationships, and diminish brand loyalty. In addition, even if the Company reacts appropriately to changes in consumer preferences, consumers may identify the Company's brand image with an outmoded fashion or the association of the brand may be limited to styles or categories



of footwear no longer in demand. There can be no assurance that the Company will successfully adapt to changing consumer demands and fashion trends, and any such failure to adapt could have a material adverse effect on the Company's business, financial condition and results of operations. Because of these risks, a number of companies in the footwear industry, and in the fashion and apparel industry, have experienced periods, which can be over several years, of rapid growth in revenues and earnings and thereafter periods of declining sales and losses which in some cases have resulted in the companies ceasing to do business. Until January 1992, several of the Company's executive officers and key employees were employed by L.A. Gear, Inc. ("L.A. Gear"), an athletic and casual footwear and apparel company, which experienced similar fluctuations. See "-- Ability to Manage Growth," "Business -- Product Design and Development" and "Management."

The Company intends to market additional lines of footwear in the future and, as is typical with new products, demand and market acceptance will be subject to uncertainty. Failure to regularly develop and introduce new products successfully could materially and adversely impact the Company's future growth and profitability. Achieving market acceptance for new products may require substantial marketing efforts. There can be no assurance that the Company's marketing efforts will be successful or that the Company will have the funds necessary to undertake sufficient efforts. See "Business -- Operating Strategies," "-- Growth Strategies" and "-- Sales."

#### RISKS RELATING TO STYLE CONCENTRATION

If any one style or group of similar styles of the Company's footwear were to represent a substantial portion of the Company's net sales, the Company could be exposed to risk should consumer demand for such style or group of styles decrease in subsequent periods. For example, in 1996, gross sales were adversely affected by decreased consumer demand for a style of footwear which represented \$16.4 million, or 14.7%, of the Company's sales, net of discounts, in 1995 and declined to \$4.7 million, or 4.0% of the Company's sales, net of discounts, in 1996. The Company attempts to hedge this risk by offering a broad range of products, and no style or group of similar styles comprised over 9.0% of the Company's sales, net of discounts, for either the year ended December 31, 1997 or the three months ended March 31, 1998. There can be no assurance that such event will not recur in the future and have a material adverse effect on the Company's business, financial condition and results of operations. See "Business -- Footwear."

#### ABILITY TO MANAGE GROWTH

The Company has experienced rapid growth over the past two years and remains vulnerable to a variety of business risks generally associated with rapidly growing companies. The Company intends to continue to pursue an aggressive growth strategy through expanded marketing and promotion efforts, frequent introductions of products, broader lines of casual and performance footwear, expansion of retail stores and increased international market penetration, all of which may place a significant strain on the Company's financial, management and other resources. The Company's future performance will depend in part on its ability to manage change in both its domestic and international operations and will require the Company to attract, train, manage and retain management, sales, marketing and other key personnel. The Company's ability to manage its growth effectively will require it to continue to improve its operational and financial control systems, infrastructure and management information systems. For example, the Company recently moved its distribution center to a larger facility and currently intends to install a new material handling system at its second distribution facility in mid-1999 at a total cost of approximately \$10.0 million. There can be no assurance that these expansion efforts will be successfully completed or that they will not interfere with existing operations. The inability of the Company's management to manage growth effectively could have a material adverse effect on the Company's business, financial condition and results of operations. See "Business -- Sales" and "Management."

#### ABILITY TO SUSTAIN PRIOR RATE OF GROWTH OR INCREASE NET SALES OR EARNINGS

From 1996 to 1997, the Company experienced a 59.3% and 205.1% increase in net sales and earnings from operations, respectively. In addition, for the quarter ended March 31, 1998, the Company realized a 117.0% increase in net sales and achieved profitability during the first calendar quarter of a fiscal

year for the first time in its history. The Company's quarterly growth rates may not be indicative of growth rates for an entire year. In the future, the Company's rate of growth will be dependent upon, among other things, the continued success of its efforts to expand its footwear offerings and distribution channels. The Company's profitability in the first calendar quarter of any fiscal year depends upon, among other things, the timing and level of advertising and trade show expenditures and the timing and level of shipments of spring merchandise. There can be no assurance that the Company's rate of growth will not decline or that it will continue to be profitable in the first calendar quarter of any succeeding fiscal year. In addition, the Company may have more difficulty maintaining its prior rate of growth to the extent it becomes larger. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Overview."

As part of its growth strategy, the Company seeks to further penetrate existing retail accounts, open its own retail stores in selected locations and increase its international operations, including in countries and territories where the Company has little distribution experience and where the Company's brand name is not yet well known. There can be no assurance that these and the Company's other growth strategies will be successful. Success will depend on various factors,

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including the strength of the Company's brand name, market success of current and new products, competitive conditions, the ability of the Company to manage increased net sales and stores and the availability of desirable locations. The Company's business also depends on general economic conditions and levels of consumer spending, which are currently high, and a decline in the economy or a recession could adversely impact the Company's business, financial condition and operating results since consumers often reduce spending on footwear and apparel in such times. The Company's business is subject to numerous other risks discussed in this section of the Prospectus. There can be no assurance that the Company will be able to increase its sales to existing customers, open and operate new retail stores or increase its international operations on a profitable basis or that the Company's operating margins will improve, and there can be no assurance that the Company's growth strategies will be successful or that the Company's net sales or net earnings will increase as a result of the implementation of such strategies. In addition, the Company has significantly expanded its infrastructure and personnel to achieve economies of scale in anticipation of continued increases in net sales. Because these expenses are fixed, at least in the short term, operating results and margins would be adversely impacted if the Company does not achieve anticipated continued growth.

#### RISKS ASSOCIATED WITH FOREIGN OPERATIONS

Substantially all of the Company's net sales for the year ended December 31, 1997 and the three months ended March 31, 1998 were derived from sales of footwear manufactured for the Company outside of the United States. During such periods, 91.6% and 89.0% of such manufactured products were produced in China, respectively. Additionally, the Company intends to increase its international sales efforts. Foreign manufacturing and sales are subject to a number of risks, including work stoppages, transportation delays, changing economic conditions, expropriation, political unrest, nationalization, the imposition of tariffs, import and export controls and other nontariff barriers, exposure to different legal standards (particularly with respect to intellectual property), burdens with complying with a variety of foreign laws and changes in domestic and foreign governmental policies, any of which could have a material adverse effect on the Company's business, financial condition and results of operations. The Company has not experienced material losses as a result of fluctuation in the value of foreign currencies. The Company's net sales and cost of goods sold are denominated in U.S. Dollars; consequently, the Company does not engage in currency hedging. Nevertheless, currency fluctuations could adversely affect the Company in the future. Also, the Company may be subjected to additional duties, significant monetary penalties, the seizure and the forfeiture of the products the Company is attempting to import or the loss of its import privileges if the Company or its suppliers are found to be in violation of U.S. laws and regulations applicable to the importation of the Company's products. Such violations may include (i) inadequate record keeping of its imported products, (ii) misstatements or errors as to the origin, quota category, classification, marketing or valuation of its imported products, (iii) fraudulent visas or (iv) labor violations under U.S. or foreign laws. There can be no assurance that the Company will not incur significant penalties (monetary or otherwise) if the United States Customs Service determines that these laws or regulations have

been violated or that the Company failed to exercise reasonable care in its obligations to comply with these laws or regulations on an informed basis. Such factors could render the conduct of business in a particular country undesirable or impractical, which could have a material adverse effect on the Company's business, financial condition and results of operations. The Company continues to monitor the political and economic stability of the Asian countries with which it conducts business. A substantial portion of the Company's footwear is manufactured in China. In June 1998, President Clinton announced that he intends to extend "most favored nation" ("MFN") non-discriminatory status to China. Under U.S. law, MFN status for China is reviewed annually. The United States has extended MFN status to China each year since 1980, however, there can be no assurance that China will continue to enjoy MFN status in the future. If goods manufactured in China enter the United States without the benefit of MFN treatment, such goods will be subject to significantly higher duty rates, ranging between 20.0% and 66.0% of customs

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value. A revocation of MFN status would result in a substantial increase in tariff rates on goods imported from China and therefore could adversely affect the Company's business, financial condition and results of operations.

Although the footwear sold by the Company is not currently subject to quotas in the United States, certain countries in which the Company's products are sold are subject to certain quotas and restrictions on foreign products which to date have not had a material adverse effect on the Company's business, financial condition and results of operations. However, such countries may alter or modify such quotas or restrictions. Countries in which the Company's products are manufactured may, from time to time, impose new or adjust quotas or other restrictions on exported products, and the United States may impose new duties, tariffs and other restrictions on imported products, any of which could have a material adverse effect on the Company's business, financial condition and results of operations and its ability to import products at the Company's current or increased quantity levels. Other restrictions on the importation of the Company's products are periodically considered by the U.S. Congress, and there can be no assurance that tariffs or duties on the Company's products may not be raised, resulting in higher costs to the Company, or that import quotas with respect to such products may not be imposed or made more restrictive.

#### DEPENDENCE ON CONTRACT MANUFACTURERS

The Company's footwear products are currently manufactured by independent contract manufacturers. For the year ended December 31, 1997 and the three months ended March 31, 1998, the top five manufacturers of the Company's manufactured products accounted for 74.8% and 40.8% of the Company's manufactured products, respectively. Two of such manufacturers accounted for 21.7% and 15.0% of total production for the year ended December 31, 1997 and one of such manufacturers accounted for 15.5% of total production for the three months ended March 31, 1998. Other than the foregoing, no one manufacturer accounted for 10.0% or more of the Company's total production for either period. The Company has no long-term contracts with its manufacturers and competes with other footwear companies for production facilities. Although the Company has established close working relationships with its principal manufacturers, the Company's future success will depend, in large part, on maintaining such relationships and developing new relationships. There can be no assurance that the Company will not experience difficulties with such manufacturers, including reduction in the availability of production capacity, failure to meet the Company's quality control standards, failure to meet production deadlines or increase in manufacturing costs. This could result in cancellation of orders, refusal to accept deliveries or a reduction in purchase prices, any of which could have a material adverse effect on the Company's business, financial condition and results of operations. In the event that the Company's current manufacturers were for any reason to cease doing business with the Company, the Company could experience an interruption in the manufacture of its products, which could have a material adverse effect on the Company's business, financial condition and results of operations. Although the Company believes that it could find alternative sources to manufacture its products within 90 to 120 days after the date of disruption, establishment of new manufacturing relationships involves various uncertainties, including payment terms, costs of manufacturing, adequacy of manufacturing capacity, quality control and timeliness of delivery. The Company cannot predict whether it will be able to establish new manufacturing relationships, either in the countries in which it currently does business or in other countries in which it does not currently do business, that

will be as favorable as those that now exist. Any significant delay in manufacture of the Company's footwear products or the inability to provide products consistent with the Company's standards, would have a material adverse effect on the Company's business, financial condition and results of operations. See "Business -- Sourcing."

The Company requires its independent contract manufacturers to operate in compliance with applicable laws and regulations. The Company requires its manufacturers to certify that neither convict, forced, indentured labor (as defined under U.S. law) nor child labor (as defined by the

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manufacturer's country) was used in the production process, that compensation will be paid in accordance with local law and that the factory is in compliance with local safety regulations. Although the Company's operating guidelines promote ethical business practices and the Company's sourcing personnel periodically visit and monitor the operations of its independent contract manufacturers, the Company does not control these vendors or their labor practices. The violation of labor or other laws by an independent contract manufacturer of the Company, or the divergence of an independent contract manufacturer's labor practices from those generally accepted as ethical in the United States, could result in adverse publicity for the Company and could have a material adverse effect on the Company's business, financial condition and results of operations.

#### DEPENDENCE ON KEY CUSTOMERS

During the year ended December 31, 1997 and the three months ended March 31, 1998, the Company's net sales to its five largest customers accounted for approximately 26.1% and 31.7% of total net sales, respectively. For the three months ended March 31, 1998, The Venator Group represented 11.4% of the Company's net sales. Other than the foregoing, no one customer accounted for 10.0% or more of net sales for either period. Although the Company has long-term relationships with many of its customers, none of its customers has any contractual obligations to purchase the Company's products. There can be no assurance that the Company will be able to retain its existing major customers. In addition, the retail industry has periodically experienced consolidation, contractions and closings and any future consolidation, contractions or closings may result in loss of customers or uncollectability of accounts receivables of any major customer in excess of amounts insured by the Company. As of December 31, 1997, Genesco represented 14.7% of trade receivables and as of March 31, 1998, Famous Footwear and The Venator Group represented 14.6% and 12.3% of trade receivables, respectively. Other than the foregoing, no one customer accounted for 10.0% or more of trade receivables for either period. The loss of or significant decrease in sales to any one of the Company's major customers or uncollectability of any accounts receivable of any major customer in excess of amounts insured could have a material adverse effect on its business, financial condition and results of operations. See "Business -- Sales."

In addition, for the year ended December 31, 1997 and the three months ended March 31, 1998, the top five salespersons accounted for 40.2% and 41.8% of the Company's net sales, respectively. Two of these salespersons generated 12.8% and 11.0% of the Company's net sales for the year ended December 31, 1997 and 16.2% and 10.8% for the three months ended March 31, 1998. Other than the foregoing, no salesperson accounted for 10.0% or more of net sales for either period. The loss of any of such salespersons may result in the disruption of service to such customers serviced by such salespersons, which could have a material adverse effect on the Company's business, financial condition and results of operations.

#### SEASONALITY; QUARTERLY FLUCTUATIONS

Sales of footwear products are somewhat seasonal in nature with the strongest sales generally occurring in the third and fourth quarters. In 1997, 34.0% of net sales and 52.5% of earnings from operations were generated in the third quarter and 33.2% of net sales and 35.1% of earnings from operations were generated in the fourth quarter. The Company has experienced and expects to continue to experience variability in its net sales, operating results and net earnings on a quarterly basis. The Company's domestic customers generally assume responsibility for scheduling pickup and delivery of purchased products. Any delay in scheduling or pickup which is beyond the Company's control, could materially negatively impact the Company's net sales and results of operations

for any given quarter. The Company believes the factors which influence this variability include (i) the timing of the Company's introduction of new footwear products, (ii) the level of consumer acceptance of new and existing products, (iii) general economic and industry conditions that affect consumer spending and retail purchasing, (iv) the timing of the placement, cancellation or pickup of customer orders, (v) increases in the number of employees and overhead to support

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growth, (vi) the timing of expenditures in anticipation of increased sales and customer delivery requirements, (vii) the number and timing of new Company retail store openings and (viii) actions by competitors. Due to these and other factors, the results for any particular quarter are not necessarily indicative of results for the full year. This cyclical nature and any related fluctuation in consumer demand could have a material adverse effect on the Company's business, financial condition and results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Quarterly Results and Seasonality" and "Business -- Sales."

#### EXPOSURE TO FLUCTUATIONS IN ECONOMIC CONDITIONS

The footwear industry in general is dependent on the economic environment and levels of consumer spending which affect not only the ultimate consumer, but also retailers, the Company's primary direct customers. Purchases of footwear tend to decline in periods of recession or uncertainty regarding future economic prospects, when consumer spending, particularly on discretionary items, declines. As a result, the Company's operating results may be adversely affected by downward trends in the economy or the occurrence of events that adversely affect the economy in general. See "Business -- Industry Overview."

#### INTENSE COMPETITION IN THE FOOTWEAR INDUSTRY

Competition in the footwear industry is intense. Although the Company believes that it does not compete directly with any single company with respect to its entire range of products, the Company's products compete with other branded products within their product category as well as with private label products sold by retailers, including some of the Company's customers. The Company's utility footwear and casual shoes compete with footwear offered by companies such as The Timberland Company, Dr. Martens, Kenneth Cole, Frye Boot and Wolverine World Wide, Inc. The Company's athletic shoes compete with brands of athletic footwear offered by companies such as Nike, Inc., Reebok International Ltd., Fila Ltd. and Converse, Inc. The Company's children's shoes compete with brands of children's footwear offered by companies such as Stride Rite, Inc. In varying degrees, depending on the product category involved, the Company competes on the basis of style, price, quality, comfort and brand name prestige and recognition, among other considerations. These and other competitors pose challenges to the Company's market share in its major domestic markets and may make it more difficult to establish the Company in Europe, Asia and other international regions. The Company also competes with numerous manufacturers, importers and distributors of footwear for the limited shelf space available for the display of such products to the consumer. Moreover, the general availability of contract manufacturing capacity allows ease of access by new market entrants. Many of the Company's competitors are larger, have achieved greater recognition for their brand names, have captured greater market share and/or have substantially greater financial, distribution, marketing and other resources than the Company. There can be no assurance that the Company will be able to compete successfully against present or future competitors or that competitive pressures faced by the Company will not have a material adverse effect on the Company's business, financial condition and results of operations. See "Business -- Competition."

#### RISKS RELATING TO ADVANCE PURCHASES OF PRODUCTS

To minimize purchasing costs, the time necessary to fill customer orders and the risk of non-delivery, the Company places orders for certain of its products with its manufacturers prior to the time the Company has received all of its customers' orders and maintains an inventory of certain products that it anticipates will be in greater demand. There can be no assurance, however, that the Company will be able to sell the products it has ordered from manufacturers or that it has in its inventory. Inventory levels in excess of customer demand may result in inventory write-downs and the sale of excess inventory at discounted prices, could significantly impair the Company's brand image and

could have a material adverse effect on the Company's business, financial condition and

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results of operations. As of December 31, 1997 and March 31, 1998, the Company had \$41.7 million and \$54.6 million of open purchase orders with its manufacturers, respectively, and \$45.8 million, and \$47.8 million of inventory at cost, respectively, relating to order backlog of \$65.8 million and \$162.3 million, respectively.

#### ADDITIONAL CAPITAL REQUIREMENTS

The Company expects that anticipated cash flow from operations, available borrowings under the Company's revolving line of credit, after the repayment of indebtedness described under "Use of Proceeds," and its financing arrangements will be sufficient to provide the Company with the liquidity necessary to fund its anticipated working capital and capital requirements through fiscal 1999. However, in connection with its growth strategy, the Company will incur significant working capital requirements and capital expenditures. The Company's future capital requirements will depend on many factors, including, but not limited to, the levels at which the Company maintains inventory, the market acceptance of the Company's footwear, the levels of promotion and advertising required to promote its footwear, the extent to which the Company invests in new product design and improvements to its existing product design and the number and timing of new store openings. To the extent that available funds are insufficient to fund the Company's future activities, the Company may need to raise additional funds through public or private financing. No assurance can be given that additional financing will be available or that, if available, it can be obtained on terms favorable to the Company. Failure to obtain such financing could delay or prevent the Company's planned expansion, which could adversely affect the Company's business, financial condition and results of operations. In addition, if additional capital is raised through the sale of additional equity or convertible securities, dilution to the Company's stockholders could occur. See "Use of Proceeds" and "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources."

#### ABILITY TO PROTECT INTELLECTUAL PROPERTY RIGHTS

The Company relies on trademark, copyright and trade secret protection, patents, non-disclosure agreements and licensing arrangements to establish, protect and enforce intellectual property rights in its products. In particular, the Company believes that its future success will depend in significant part on the Company's ability to maintain and protect the Skechers trademark. Despite the Company's efforts to safeguard and maintain its intellectual property rights, there can be no assurance that the Company will be successful in this regard. There can be no assurance that third parties will not assert intellectual property claims against the Company in the future. Furthermore, there can be no assurance that the Company's trademarks, products and promotional materials do not or will not violate the intellectual property rights of others, that they would be upheld if challenged or that the Company would, in such an event, not be prevented from using its trademarks and other intellectual property. Such claims, if proved, could materially and adversely affect the Company's business, financial condition and results of operations. In addition, although any such claims may ultimately prove to be without merit, the necessary management attention to and legal costs associated with litigation or other resolution of future claims concerning trademarks and other intellectual property rights, could materially and adversely affect the Company's business, financial condition and results of operations. The Company has in the past sued and been sued by third parties in connection with certain matters regarding its trademarks, none of which has materially impaired the Company's ability to utilize its trademarks.

The laws of certain foreign countries do not protect intellectual property rights to the same extent or in the same manner as do the laws of the United States. Although the Company continues to implement protective measures and intends to defend its intellectual property rights vigorously, there can be no assurance that these efforts will be successful or that the costs associated with protecting its rights in certain jurisdictions will not be prohibitive.

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From time to time, the Company discovers products in the marketplace that

are counterfeit reproductions of the Company's products or that otherwise infringe upon intellectual property rights held by the Company. There can be no assurance that actions taken by the Company to establish and protect its intellectual property rights will be adequate to prevent imitation of its products by others or to prevent others from seeking to block sales of the Company's products as violating intellectual property rights. If the Company is unsuccessful in challenging a third party's products on the basis of infringement of its intellectual property rights, continued sales of such product by that or any other third party could adversely impact the Skechers trademark, result in the shift of consumer preferences away from the Company and generally have a material adverse effect on the Company's business, financial condition and results of operations. See "Business -- Intellectual Property Rights."

#### DEPENDENCE ON KEY PERSONNEL

The Company's success depends to a large extent upon the expertise and continuing contributions of Robert Greenberg, Chairman of the Board and Chief Executive Officer, Michael Greenberg, President, and David Weinberg, Executive Vice President and Chief Financial Officer. The loss of the services of any of these individuals or any other key employee could have a material adverse effect on the Company's business, financial condition and results of operations. The Company's future success also depends on its ability to identify, attract and retain additional qualified personnel. The competition for such employees is intense, and there can be no assurance that the Company will be successful in identifying, attracting and retaining such personnel. The Company maintains \$5.0 million of "key man" life insurance on the life of Robert Greenberg. The loss of key employees or the inability to hire or retain qualified personnel in the future could have a material adverse effect on the Company's business, financial condition and results of operations. See "Management -- Directors, Executive Officers and Key Employees."

#### CONTROL OF THE COMPANY BY PRINCIPAL STOCKHOLDER

After the Offering, Robert Greenberg, Chairman of the Board and Chief Executive Officer, will beneficially own % of the outstanding Common Stock of the Company (or approximately % of the outstanding Common Stock if the Underwriters' over-allotment option is exercised in full). As a result, Mr. Greenberg will be able to control substantially all matters requiring approval by the stockholders of the Company, including the election of directors and the approval of mergers or other business combination transactions, and will also have control over the management and affairs of the Company. As a result of such control, certain transactions may not be possible without the approval of Mr. Greenberg, including proxy contests, tender offers, open market purchase programs or other transactions that could give stockholders of the Company the opportunity to realize a premium over the then-prevailing market prices for their shares of Common Stock. See "Management" and "Principal Stockholders."

#### ANTI-TAKEOVER PROVISIONS

The Company is subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law ("DGCL"). In general, Section 203 prevents an "interested stockholder" (defined generally as a person owning more than 15.0% or more of the Company's outstanding voting stock) from engaging in a "business combination" with the Company for three years following the date that person became an interested stockholder unless the business combination is approved in a prescribed manner. This statute could make it more difficult for a third party to acquire control of the Company. See "Description of Capital Stock -- Section 203 of the Delaware General Corporation Law."

The Board of Directors has the authority to issue up to 10,000,000 shares of Preferred Stock and to determine the rights, preferences, privileges and restrictions of such shares without any further vote or action by the stockholders. Although at present the Company has no plans to issue any shares of Preferred Stock, Preferred Stock could be issued with voting, liquidation, dividend and other

rights superior to the rights of the Common Stock. The issuance of Preferred Stock under certain circumstances could have the effect of delaying or preventing a change in control of the Company. See "Description of Capital Stock."

Mr. Greenberg's substantial beneficial ownership position, together with the authorization of Preferred Stock, the classification of the Board of Directors and the lack of cumulative voting in the Company's Certificate of Incorporation and Bylaws, may have the effect of delaying, deferring or preventing a change in control of the Company, may discourage bids for the Company's Common Stock at a premium over the market price of the Common Stock and may adversely affect the market price of the Common Stock. See "Principal Stockholders" and "Description of Capital Stock."

#### NO ASSURANCE OF ACTIVE TRADING MARKET FOR COMMON STOCK AND POSSIBLE VOLATILITY OF STOCK PRICE

Prior to the Offering, there has been no public market for the Company's Common Stock. Although the Company intends to apply for listing of the Common Stock on the New York Stock Exchange, there can be no assurance that an active public trading market for the Common Stock will develop after the Offering or that, if developed, it will be sustained. The public offering price of the Common Stock offered hereby will be determined by negotiations between the Company, the Selling Stockholder and the Representatives of the Underwriters and may not be indicative of the price at which the Common Stock will trade after the Offering. Consequently, there can be no assurance that the market price for the Common Stock will not fall below the initial public offering price. The market price for shares of the Common Stock may be volatile and may fluctuate based upon a number of factors, including, without limitation, business performance, news announcements, quarterly fluctuations in the Company's financial results, changes in earnings estimates or recommendations by analysts or changes in general economic and market conditions. See "Underwriting."

#### SHARES ELIGIBLE FOR FUTURE SALE

The sales of substantial amounts of the Company's Common Stock in the public market or the prospect of such sales could materially and adversely affect the market price of the Common Stock. Upon completion of the Offering, the Company will have outstanding \_\_\_\_\_ shares of Common Stock. The \_\_\_\_\_ shares of Common Stock offered hereby will be immediately eligible for sale in the public market without restriction beginning on the date of this Prospectus. The remaining \_\_\_\_\_ shares of Common Stock are restricted in nature and are saleable pursuant to Rule 144 under the Securities Act of 1933, as amended (the "Securities Act"). All executive officers, directors, stockholders and optionholders of the Company have agreed that they will not, without the prior written consent of BT Alex. Brown Incorporated on behalf of the Underwriters (which consent may be withheld in its sole discretion) and subject to certain limited exceptions, offer, pledge, sell, contract to sell, sell any option or contract to purchase, sell short, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend, or otherwise transfer or dispose of, directly or indirectly, any shares of Common Stock, or any securities convertible into or exercisable or exchangeable for Common Stock, or enter into any swap or similar agreement that transfers in whole or in part, any of the economic consequences of ownership of the Common Stock, for a period commencing on the date of this Prospectus and continuing to a date 180 days after such date; provided, however, that such restrictions do not apply to shares of Common Stock sold or purchased in the Offering or to shares of Common Stock purchased in the open market following the Offering. BT Alex. Brown Incorporated, on behalf of the Underwriters, may, in its sole discretion and at any time without notice, release all or any portion of the securities subject to these lock-up agreements. Robert Greenberg, Chairman of the Board and Chief Executive Officer, and Michael Greenberg, President, beneficially own an aggregate of \_\_\_\_\_ shares of Common Stock for which they have received certain registration rights to sell such shares in the public market. The Company also

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intends to register under the Securities Act shares reserved for issuance pursuant to the Stock Option Plan and the 1998 Purchase Plan. See "Shares Eligible for Future Sale" and "Underwriting."

#### YEAR 2000 COMPLIANCE

The Company is assessing the internal readiness of its computer systems for handling the year 2000 issue. The Company expects to implement the systems and programming changes necessary to address year 2000 issues with respect to its internal systems and does not believe that the cost of such actions will have a



material adverse effect on its business, financial condition and results of operations or financial condition. Although the Company is not aware of any material operational issues or costs associated with preparing its internal systems for the year 2000, there can be no assurance that there will not be a delay in, or increased costs associated with, the implementation of the necessary systems and changes to address the year 2000 issues, and the Company's inability to implement such systems and changes in a timely manner could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company also relies, directly and indirectly, on external systems of business enterprises such as third party manufacturers and suppliers, customers, creditors and financial organizations, and of governmental entities, both domestic and international, for accurate exchange of data. Even if the internal systems of the Company are not materially affected by the year 2000 issue, the Company could be affected by disruptions in the operation of the enterprises with which the Company interacts. Despite the Company's efforts to address the year 2000 impact on its internal systems and business operations, there can be no assurance that such impact will not result in a material disruption of its business or have a material adverse effect on the Company's business, financial condition and results of operations.

#### IMMEDIATE AND SUBSTANTIAL DILUTION

The anticipated initial public offering price is substantially higher than the book value per outstanding share of the Common Stock. Purchasers of the Common Stock will experience immediate and substantial dilution in net tangible book value of \$ per share (based upon an assumed initial public offering price of \$ per share) from the assumed initial public offering price per share of Common Stock. Moreover, to the extent outstanding options to purchase Common Stock are exercised in the future, there will be further dilution. See "Dilution."

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#### USE OF PROCEEDS

The net proceeds to be received by the Company from the sale of the shares of Common Stock offered by the Company (after deducting the underwriting discounts and commissions and estimated Offering expenses payable by the Company) are estimated to be \$91.0 million. The Company intends to apply the net proceeds from the Offering (i) to repay approximately \$55.7 million anticipated to be owed under its revolving line of credit, (ii) to repay approximately \$13.3 million owed under a term note, (iii) to make the Final Tax Distribution, consisting of income taxes payable on S Corporation earnings from January 1, 1998 through the date of termination of the Company's S Corporation status and is anticipated to be \$7.0 million and (iv) to make the Final S Corporation Distribution, which is designed to constitute substantially all of the Company's remaining undistributed accumulated S Corporation earnings through the date of termination of the Company's S Corporation status and is anticipated to be \$15.0 million.

The revolving line of credit and the term note to be repaid are part of a credit facility provided by Heller Financial, Inc. The revolving line of credit provides for borrowings of up to \$120.0 million and bears interest at the Company's option at either the prime rate (8.5% at June 30, 1998) plus 25 basis points or at Libor (5.78% at June 30, 1998) plus 2.75%; the Company has elected to designate the Libor rate. Approximately \$40.1 million was outstanding under the revolving line of credit as of June 30, 1998. By repaying this indebtedness, the Company expects to have additional flexibility and liquidity to pursue its growth strategies. The term note bears interest at the prime rate plus 25 basis points and is due in full in June 1999. The proceeds from the issuance of this term note were used to repay a note in the principal amount of approximately \$13.3 million owed to the Greenberg Family Trust of which Robert Greenberg, Chairman of the Board and Chief Executive Officer, is a trustee (the "Stockholder Note"). The term note is guaranteed by the Greenberg Family Trust and is collateralized by approximately \$13.3 million in cash pledged by the Greenberg Family Trust to support its guaranty.

The Company will not receive any proceeds from the sale of shares of Common Stock by the Selling Stockholder.

#### PRIOR S CORPORATION STATUS

In May 1992, the Company elected to be treated for Federal and state income tax purposes as an S Corporation under Subchapter S of the Internal Revenue Code of 1986, as amended (the "Code"), and comparable state laws. As a result, earnings of the Company, since such initial election, have been included in the taxable income of the Company's stockholders for Federal and state income tax purposes, and the Company has not been subject to income tax on such earnings, other than franchise and net worth taxes. Prior to the closing of the Offering, the Company will terminate its S Corporation status, and the Company will be treated for Federal and state income tax purposes as a corporation under Subchapter C of the Code and, as a result, will become subject to state and Federal income taxes.

By reason of the Company's treatment as an S Corporation for Federal and state income tax purposes, the Company, since inception, has provided to its stockholders funds for the payment of income taxes on the earnings of the Company. The Company paid dividends consisting of amounts attributable to payment of such taxes of \$170,000, \$112,000 and \$3.2 million in 1995, 1996 and 1997, respectively. In addition, in August 1998, the Company anticipates making the August Tax Distribution consisting of the final installment of income taxes payable on S Corporation earnings for 1997. The amount of the August Tax Distribution is estimated to be approximately \$3.6 million.

Upon the termination of the Company's S Corporation status, the Company will declare (i) the Final Tax Distribution consisting of income taxes payable on S Corporation earnings from January 1, 1998 through the date of termination of the Company's S Corporation status, and (ii) the Final S Corporation Distribution in an amount designed to constitute substantially all of the Company's remaining undistributed accumulated S Corporation earnings through the date of termination of the

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Company's S Corporation status. The Company estimates that the amount of the Final Tax Distribution will be approximately \$7.0 million and the amount of the Final S Corporation Distribution will be approximately \$15.0 million; such amounts will be paid with a portion of the net proceeds of the Offering. See "Use of Proceeds." Purchasers of shares of Common Stock in the Offering will not receive any portion of the August Tax Distribution, the Final Tax Distribution or the Final S Corporation Distribution. On and after the date of such termination, the Company will no longer be treated as an S Corporation and, accordingly, will be fully subject to Federal and state income taxes. All pro forma income taxes reflect adjustments for Federal and state income taxes as if the Company had been taxed as a C Corporation rather than an S Corporation.

In connection with the Offering and the termination of the Company's S Corporation tax status, the Company will enter into a tax indemnification agreement with each of its stockholders. The agreement will provide that the Company will indemnify and hold harmless each of the stockholders for Federal, state, local or foreign income tax liabilities, and costs relating thereto, resulting from any adjustment to the Company's income that is the result of an increase or change in character of the Company's income during the period it was treated as an S Corporation. The agreements will also provide that if there is a determination that the Company was not an S Corporation prior to the Offering, the stockholders will pay to the Company certain refunds actually received by them as a result of that determination.

#### DIVIDEND POLICY

The Company anticipates that after payment of the August Tax Distribution in August 1998 and after the payment of the Final Tax Distribution and the Final S Corporation Distribution in connection with the termination of the S Corporation status of the Company, all earnings will be retained for the foreseeable future for use in the operations of the business. Purchasers of shares of Common Stock in the Offering will not receive any portion of the August Tax Distribution, the Final Tax Distribution or the Final S Corporation Distribution. Any future determination as to the declaration or payment of dividends will be at the discretion of the Company's Board of Directors and will depend upon the Company's results of operations, financial condition, contractual restrictions and other factors deemed relevant by the Board of Directors. The Company's credit facility prohibits the payment of dividends by the Company if the Company is in default of any provisions of the credit facility. For certain information regarding S Corporation distributions made by

the Company in 1995, 1996 and 1997 and the August Tax Distribution, the Final Tax Distribution and the Final S Corporation Distribution, see "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources."

CAPITALIZATION

The following table sets forth the capitalization of the Company (i) on an actual basis as of March 31, 1998 (when the Company was an S Corporation), (ii) pro forma to reflect the August Tax Distribution estimated to be \$3.6 million and (iii) pro forma as adjusted to reflect (A) the Final Tax Distribution estimated to be \$7.0 million and the Final S Corporation Distribution estimated to be \$15.0 million to be made in connection with the termination of the Company's S Corporation status (see "Prior S Corporation Status"), (B) the recording by the Company of \$1.3 million of deferred tax assets as if the Company were treated as a C Corporation since its inception and (C) the issuance and sale of the shares of Common Stock offered by the Company at an assumed initial public offering price of \$ per share (the mid-point of the range), after deducting the underwriting discounts and commissions and estimated Offering expenses payable by the Company, and the anticipated application of the estimated net proceeds therefrom. This table should be read in conjunction with the Financial Statements and the Notes thereto included elsewhere in this Prospectus.

<TABLE>  
<CAPTION>

	AS OF MARCH 31, 1998		
	PRO FORMA,		
	ACTUAL	PRO FORMA	AS ADJUSTED
	(IN THOUSANDS, EXCEPT SHARE DATA)		
<S>	<C>	<C>	<C>
Short-term debt(1).....	\$47,896	\$47,896	\$ 300
Long-term debt:			
Note payable to stockholder.....	\$13,250	\$13,250	\$ --
Other long-term debt.....	2,600	2,600	2,600
Stockholders' equity:			
Preferred Stock, \$.001 par value; 10,000,000 shares authorized; none issued and outstanding actual and as adjusted.....	--	--	--
Common Stock, \$.001 par value; 100,000,000 shares authorized; issued and outstanding actual; issued and outstanding as adjusted(2).....	--	2	2
Additional paid-in capital.....	--	--	91,002
Retained earnings (accumulated deficit).....	11,872	8,272	(12,437)
Total stockholders' equity.....	11,874	8,274	78,565
Total capitalization.....	\$27,724	\$24,124	\$81,165

</TABLE>

(1) Includes the current installments of other long-term debt.

(2) Excludes options to acquire shares outstanding as of March 31, 1998, at a per share exercise price of \$ . Options to purchase an aggregate of shares are expected to be granted to certain employees and non-employee directors of the Company at the effective date of the Offering at a per share exercise price equal to the initial public offering price. See "Management -- Stock Options."

DILUTION

The pro forma net tangible book value of the Company's Common Stock at March 31, 1998 was approximately \$ million or \$ per share. Pro forma net tangible book value per share represents total tangible assets reduced

by the amount of total liabilities, divided by the number of shares of Common Stock outstanding, after giving effect to (i) the August Tax Distribution estimated to be \$3.6 million which will be paid in August 1998 and (ii) the Final Tax Distribution estimated to be \$7.0 million and the Final S Corporation Distribution estimated to be \$15.0 million and payment of each thereof with a portion of the net proceeds of the Offering (see "Prior S Corporation Status"). After giving effect to the sale by the Company of the shares of Common Stock offered by the Company hereby at an assumed initial public offering price of \$ per share (the mid-point of the range), after deducting the underwriting discounts and commissions and estimated Offering expenses, the pro forma as adjusted net tangible book value of the Company at March 31, 1998 would have been \$ million or \$ per share of Common Stock. This represents an immediate increase in pro forma net tangible book value of \$ per share to existing stockholders and an immediate and substantial dilution of \$ per share to new investors purchasing shares in the Offering. The following table illustrates this per share dilution:

<TABLE>

<S>	<C>	<C>	
Assumed initial public offering price per share.....			\$
Pro forma net tangible book value per share as of March 31, 1998.....	\$		
Increase per share attributable to new investors.....			
		-----	
Pro forma as adjusted net tangible book value per share after the Offering.....			
		-----	
Dilution per share to new investors.....			\$
		=====	

</TABLE>

The following table summarizes, on a pro forma basis as of March 31, 1998, after giving effect to the adjustments set forth above, the number of shares of Common Stock purchased from the Company, the total consideration paid to the Company and the average price per share of Common Stock paid by the existing stockholders and by the new investors in the Offering:

<TABLE>

<CAPTION>

	SHARES PURCHASED		TOTAL CONSIDERATION		AVERAGE PRICE PER SHARE
	NUMBER	PERCENT	AMOUNT	PERCENT	
<S>	<C>	<C>	<C>	<C>	<C>
Existing stockholders.....		%	\$	%	\$
New investors.....					\$
	---	---	---	---	
Total.....		100.0%	\$	100.0%	
	====	=====	=====	=====	

</TABLE>

The above tables exclude shares issuable upon the exercise of outstanding stock options at an exercise price of \$ . To the extent outstanding options are exercised, new investors will experience further dilution. See "Management -- Stock Options -- 1998 Stock Option Plan," "-- 1998 Employee Stock Purchase Plan" and Note 5 of Notes to Financial Statements.

SELECTED FINANCIAL DATA  
(IN THOUSANDS, EXCEPT PER SHARE DATA)

The selected data presented below under the captions "Statement of Operations Data" and "Balance Sheet Data" for, and as of the end of, each of the years in the five-year period ended December 31, 1997, are derived from the financial statements of Skechers U.S.A., Inc., which financial statements have been audited by KPMG Peat Marwick LLP, independent certified public accountants. The financial statements as of December 31, 1996 and 1997, and for each of the years in the three-year period ended December 31, 1997, and the report thereon, are included elsewhere in this Prospectus. The selected financial data presented below under the caption "Pro Forma Statement of Operations Data," and the selected statement of operations data for the three months ended March 31, 1997

and 1998, and the selected balance sheet data as of March 31, 1998, have been derived from the unaudited financial statements of the Company, and include all adjustments, consisting solely of normal recurring accruals, which management considers necessary for a fair presentation of such financial information for those periods. Results of operations for the three months ended March 31, 1998 are not necessarily indicative of results for the full year.

<TABLE>  
<CAPTION>

	THREE MONTHS ENDED						
	YEAR ENDED DECEMBER 31,				MARCH 31,		
	1993	1994	1995	1996	1997	1997	1998
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
STATEMENT OF OPERATIONS DATA:							
Net sales.....	\$42,725	\$90,755	\$110,649	\$115,410	\$183,827	\$27,591	\$59,873
Cost of sales.....	27,131	61,579	78,692	81,199	115,104	18,384	37,390
Gross profit.....	15,594	29,176	31,957	34,211	68,723	9,207	22,483
Royalty income, net.....	--	1,012	1,843	1,592	894	612	132
	15,594	30,188	33,800	35,803	69,617	9,819	22,615
Operating expenses:							
Selling.....	4,081	10,872	12,150	11,739	21,584	3,715	7,017
General and administrative.....	6,699	15,810	19,850	18,939	32,397	6,403	13,093
	10,780	26,682	32,000	30,678(1)	53,981	10,118	20,110
Earnings (loss) from operations....	4,814	3,506	1,800	5,125	15,636	(299)	2,505
Other income (expense):							
Interest.....	(642)	(2,461)	(3,676)	(3,231)	(4,186)	(700)	(1,484)
Other, net.....	(38)	18	214	61	(37)	68	64
	(680)	(2,443)	(3,462)	(3,170)	(4,223)	(632)	(1,420)
Earnings (loss) before income taxes and extraordinary credit.....	4,134	1,063	(1,662)	1,955	11,413	(931)	1,085
State income taxes (benefit) -- all current.....	123	54	3	45	390	(32)	33
Earnings (loss) before extraordinary credit.....	4,011	1,009	(1,665)	1,910	11,023	(899)	1,052
Extraordinary credit, net of state income taxes.....	--	--	443(2)	--	--	--	--
Net earnings (loss).....	\$ 4,011	\$ 1,009	\$(1,222)	\$ 1,910	\$11,023	\$ (899)	\$ 1,052

PRO FORMA STATEMENT OF OPERATIONS

DATA(3):							
Earnings (loss) before income taxes and extraordinary credit.....	\$ 4,134	\$ 1,063	\$(1,662)	\$ 1,955	\$11,413	\$ (931)	\$ 1,085
Income taxes (benefit).....	1,654	425	(665)	782	4,565	(372)	434
Earnings (loss) before extraordinary credit.....	2,480	638	(997)	1,173	6,848	(559)	651
Extraordinary credit, net of state income taxes.....	--	--	270(2)	--	--	--	--
Net earnings (loss).....	\$ 2,480	\$ 638	\$( 727)	\$ 1,173	\$ 6,848	\$ (559)	\$ 651

Net earnings per share(4):

Basic.....		\$	\$
Diluted.....		\$	\$
Weighted average shares(4):.....			
Basic.....			
Diluted.....			

</TABLE>

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<TABLE>

<CAPTION>

AS OF DECEMBER 31,

	1993	1994	1995	1996	1997	AS OF MARCH 31, 1998
BALANCE SHEET DATA:						
Working capital.....	\$11,615	\$ 8,930	\$ 8,155	\$11,987	\$17,081	\$17,246
Total assets.....	23,339	43,575	47,701	42,151	90,881	96,436
Total debt.....	16,285	28,180	31,748	25,661	39,062	63,746
Stockholders' equity.....	2,436	2,330	938	3,336	11,125	11,874

</TABLE>

- (1) Operating expenses for 1996 include a \$530,000 charge to operations related to costs of the terminated public offering of the "Kani" division.
- (2) Includes an extraordinary gain of \$443,000 net of state income taxes of \$7,000 (\$270,000 on a pro forma basis, net of \$180,000) resulting from the acceleration of the repayment of a note. See Note 12 of Notes to Financial Statements.
- (3) Reflects adjustments for Federal and state income taxes as if the Company had been taxed as a C Corporation, at the assumed rate of 40.0%, rather than as an S Corporation.
- (4) Weighted average diluted shares outstanding for the three months ended March 31, 1998 include shares issuable upon exercise of stock options outstanding, after applying the treasury stock method based on an assumed initial public offering price of \$ per share (the mid-point of the range). The weighted average diluted shares also give effect to the sale by the Company of those shares of Common Stock necessary to fund the payment of the excess of (i) the sum of stockholder distributions during the previous 12-month period (during fiscal 1997 for the determination of shares outstanding for fiscal 1997, and during the 15 months ended March 31, 1998 for the determination of shares outstanding for the three month period ended March 31, 1998) and distributions paid or declared thereafter until the consummation of the Offering in excess of (ii) the S Corporation earnings in the previous 12-month period (for the year ended December 31, 1997, and 15 months for the three months ended March 31, 1998), based on an assumed initial public offering price of \$ per share (the mid-point of the range), net of underwriting discounts and estimated Offering expenses. See "Capitalization" and "Management -- Stock Options." For further information pertaining to the calculation of earnings per share, see Note 1 of Notes to Financial Statements.

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#### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Company's financial statements and notes thereto appearing elsewhere herein. This section contains certain forward-looking statements that involve risks and uncertainties including, but not limited to, information with regard to the Company's plans to increase the number of retail locations and styles of footwear, the maintenance of customer accounts and expansion of business with such accounts, the successful implementation of the Company's strategies, future growth and growth rates, and future increases in net sales, expenses, capital expenditures and net earnings. Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects," "may," "will," "intends," "estimates" and similar expressions are intended to identify forward-looking statements. These forward-looking statements involve risks and uncertainties, and the Company's actual results may differ materially from the results discussed in the forward-looking statements as a result of certain factors set forth in "Risk Factors" and elsewhere in this Prospectus.

## OVERVIEW

The Company designs and markets branded contemporary casual, active, rugged and lifestyle footwear for men, women and children. The Company sells its products to department stores and specialty retailers such as Nordstrom, Macy's, Dillards, Robinson's-May and JC Penney, and specialty retailers such as Genesco's Journeys and Jarman chains, The Venator Group's Foot Locker and Lady Foot Locker chains, Pacific Sunwear and Florsheim. The Company's marketing focus is to maintain and enhance recognition of the Skechers brand name as a casual, active, youthful, lifestyle brand that stands for quality, comfort and design innovation. Towards this end, the Company endeavors to spend approximately 8.0% of net sales in the marketing of Skechers footwear through an integrated effort of advertising, promotions, public relations, trade shows and other marketing efforts.

The Company was founded in 1992 as a distributor of Dr. Martens footwear. The Company began designing and marketing men's footwear under the Skechers brand name and other brand names including "Cross Colours," "Karl Kani" and "So . . . L.A." in 1993. Shortly after launching these branded footwear lines, the Company discontinued distributing Dr. Martens footwear. In 1995, the Company began to shift its focus to the Skechers brand name by de-emphasizing the sale of "Kani" branded products and discontinuing the sale of "Cross Colours" and "So . . . L.A." branded footwear. In early 1996, the Company substantially increased its product offerings in and marketing focus on its Skechers women's and children's lines. The Company divested the "Karl Kani" license in August 1997. Substantially all of the Company's products are marketed under the Skechers name.

Management believes the Skechers product offerings of men's, women's and children's footwear appeal to a broad customer base between the ages of 5 and 40 years. Skechers men's and women's footwear are primarily designed with the active, youthful lifestyle of the 12 to 25 year old age group in mind. Products include basic styles, which are styles that have been in the Company's line for at least three consecutive seasons and seasonal or fashion styles, which are designed to establish or capitalize on market trends. The Company increased its styles offered from approximately 390 for the three months ended March 31, 1997 to approximately 600 for the three months ended March 31, 1998. For the three months ended March 31, 1998, approximately 54.0% of the Company's gross sales of men's footwear were generated from basic styles that have been in the Company's line for at least three seasons. Management's goal is to achieve a comparable portion of gross sales of its women's and children's lines in its basic styles with sufficient operating history. The Company's women's and children's lines have only recently been expanded and emphasized, and many styles within these lines have only recently been introduced.

The Company has realized rapid growth since inception, increasing net sales from \$42.7 million in 1993 to \$183.8 million in 1997. From 1996 to 1997, the Company experienced a 59.3% and 205.1% increase in net sales and earnings from operations, respectively. The Company also

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experienced an improvement in gross profit as a percentage of net sales from 29.6% to 37.4% and in earnings from operations as a percentage of net sales from 4.4% to 8.5% over this same period, resulting in part from the shift to offering Skechers product exclusively and in part from economies of scale. For the quarter ended March 31, 1998, the Company realized a 117.0% increase in net sales compared to the comparable period from the prior year while increasing gross profit as a percentage of net sales from 33.4% to 37.6%. In the future, the Company's rate of growth will be dependent upon, among other things, the continued success of its efforts to expand its footwear offerings. There can be no assurance that the rate of growth will not decline in future periods or that the Company will improve or maintain operating margins.

As the Company's net sales growth has accelerated, management has focused on investing in infrastructure to support continued expansion in a disciplined manner. Major areas of investment have included the expansion of the Company's distribution facilities, hiring of additional personnel, development of product sourcing and quality control offices in Taiwan, upgrading the Company's management information systems and development and expansion of Company's retail stores. The Company has established this infrastructure to achieve further economies of scale in anticipation of continued increases in net sales. Because expenses relating to this infrastructure are fixed, at least in the short-term,

operating results and margins would be adversely affected if the Company does not achieve anticipated continued growth.

The Company operates 14 concept stores at marquee locations in major metropolitan cities. Each concept store serves not only as a showcase for the Company's full product offering for the current season but also as a rapid product feedback mechanism. Product sell-through information derived from the Company's concept stores enables the Company's sales, merchandising and production staff to respond to market changes and new product introductions. Such responses serve to augment sales and limit inventory markdowns and customer returns and allowances. The Company also operates 12 factory and warehouse outlet stores that enable the Company to liquidate excess, discontinued and odd-size inventory in a cost efficient manner. Each of the Company's concept stores and outlet stores that was open for a full quarter made a positive contribution to earnings in 1997. The Company plans to increase the number of retail locations in the future to further its strategic goals as well as in an effort to increase net sales and net earnings. The Company plans to open at least four new concept stores and two new outlet stores in the remainder of 1998 and approximately seven new concept stores and 11 new outlet stores in 1999. For the year ended December 31, 1997 and the three months ended March 31, 1998, approximately 5.3% and 5.8% of net sales were generated by the Company's retail stores, respectively.

During 1997, Skechers sold to approximately 2,022 retail accounts representing in excess of 10,000 storefronts. For the three months ended March 31, 1998, The Venator Group represented 11.4% of the Company's net sales. Other than the foregoing, no one customer accounted for 10.0% or more of the Company's net sales for either period. Management has implemented a strategy of controlling the growth of the distribution channels through which the Company's products are sold in order to protect the Skechers brand name, properly service customer accounts and better manage the growth of the business. The Company has limited distribution of product to those retailers which management believes can best support the Skechers brand name in the market. In April 1998, the Company made the decision to discontinue opening new accounts through December 1998. Although the Company does intend to open new customer accounts in the future, management believes that by focusing on the Company's existing accounts, the Company can deepen its relationships with its existing customers by providing a heightened level of customer service. Increasing sales to existing customers and the opening of additional retail stores will depend on various factors, including strength of the Company's brand name, competitive conditions, the ability of the Company to manage the increased sales and stores and the availability of desirable locations. There can be no assurance that the Company will be able to increase its sales to existing customers or to open and operate new retail stores on a profitable basis. There can be no assurance that the

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Company's growth strategy will be successful or that the Company's net sales or net earnings will increase as a result of the implementation of such efforts.

Although the Company's primary focus is on the domestic market, the Company presently markets its product in countries in Europe, Asia and selected other foreign regions through distributorship agreements. For the year ended December 31, 1997 and the three months ended March 31, 1998, approximately 15.1% and 13.6%, of the Company's net sales was derived from its international operations, respectively. To date, substantially, all international sales have been made in U.S. Dollars, although there can be no assurance that this will continue to be the case. The Company's goal is to increase sales through distributors by heightening the Company's marketing support in these countries. Sales through foreign distributors result in lower gross margins to the Company than domestic sales. To the extent that the Company expands its international operations through distribution arrangements, its overall gross margins may be adversely affected. In 1998, the Company launched its first major international advertising campaign in Europe and Asia. In an effort to increase profit margins on products sold internationally and more effectively promote the Skechers brand name, the Company is exploring selling directly to retailers in certain European countries in the future. In addition, the Company plans to begin selectively opening flagship retail stores internationally on its own or through joint ventures. There can be no assurance that such expansion plans will be successful.

Management believes that selective licensing of the Skechers brand name to non-footwear-related manufacturers may broaden and enhance the Skechers image



without requiring significant capital investments or the incurrence of significant incremental operating expenses by the Company. Although the Company has licensed certain manufacturers to produce and market a variety of Skechers products, to date it has not derived any significant royalty income from such licensing arrangements. Royalty income is recognized as revenue when earned. The substantial portion of the Company's royalty income to date was derived from royalties paid in connection with sales of "Karl Kani" licensed apparel. The Company divested the license in August 1997. Management believes that revenues from licensing agreements will not be a material source of growth for the Company in the near term; however, management believes that such revenues may present an attractive long-term opportunity with minimal near-term costs.

The Company contracts with third parties for the manufacture of all of its products. The Company does not own or operate any manufacturing facilities. For the year ended December 31, 1997 and the three months ended March 31, 1998, the top five manufacturers of the Company's products accounted for 74.8% and 40.8% of the Company's manufactured products, respectively. Two of such manufacturers accounted for 21.7% and 15.0% of total production for the year ended December 31, 1997 and one of such manufacturers accounted for 15.5% of total production for the three months ended March 31, 1998. Other than the foregoing, no one manufacturer accounted for more than 10.0% of the Company's total production for such periods. To date, substantially all products are purchased in U.S. Dollars, although there can be no assurance that this will continue to be the case. The Company believes the use of independent manufacturers increases its production flexibility and capacity while at the same time allowing the Company to substantially reduce capital expenditures and avoid the costs of managing a large production work force. Substantially all of the Company's products are produced in China. The Company finances its production activities in part through the use of interest-bearing open purchase agreements with its Asian manufacturers. These facilities typically bear interest at a rate between 12.0% and 15.0% per annum. Management believes that the use of these unsecured facilities affords the Company additional liquidity and flexibility.

Finished goods are reviewed, inspected and shipped from the Company's approximately 412,000 square foot leased distribution center located in Ontario, California, or are drop-shipped directly from the manufacturer to Skechers' international distributors. The Company has recently entered into a lease for an additional 286,000 square foot distribution facility. The Company intends to install a new material handling system in its new distribution center to enhance its ability to

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monitor inventory levels and distribution activities at such site. The system, which is expected to cost \$10.0 million, is expected to become operational in mid-1999.

As a result of the Company's strategic decision in 1995 to focus on its Skechers branded products, the Company conducted substantial close-out sales of its "Kani," "Cross Colours" and "So . . . L.A." discontinued product lines in 1996 and 1997. These inventory close-outs were substantially concluded during the first three months of 1998, and the Company currently has only a nominal amount of "Kani" inventory on hand. As a result of substantial markdowns necessary to liquidate this discontinued inventory, the Company's gross margins were adversely affected in 1996 and 1997 and, to a lesser extent, in the first three months of 1998.

As a result of the substantial growth of the Company's backlog in 1997 and in anticipation of deliveries of these orders during the first three months of 1998, inventory levels at December 31, 1997 were higher than in previous periods. If the Company continues to grow at or near its current rate, it is expected that inventory levels will continue to expand to meet customer advance orders.

In May 1992, the Company elected to be treated for Federal and state income tax purposes as an S Corporation under Subchapter S of the Code and comparable state laws. As a result, earnings of the Company, since such initial election, have been included in the taxable income of the Company's stockholders for Federal and state income tax purposes, and the Company has not been subject to income tax on such earnings, other than franchise and net worth taxes. Upon the termination of the Company's S Corporation status, the Company will be treated for Federal and state income tax purposes as a corporation under Subchapter C of the Code and, as a result, will become subject to state and Federal income

taxes. By reason of the Company's treatment as an S Corporation for Federal and state income tax purposes, the Company, since inception, has provided to its stockholders funds for the payment of income taxes on the earnings of the Company. The Company paid dividends consisting of amounts attributable to payment of such taxes of \$170,000, \$112,000 and \$3.2 million in 1995, 1996 and 1997, respectively. In addition, in August 1998, the Company anticipates making the August Tax Distribution consisting of the final installment of income taxes payable on S Corporation earnings for 1997. The amount of the August Tax Distribution is estimated to be approximately \$3.6 million. Upon the termination of the Company's S Corporation status, the Company will also declare (i) the Final Tax Distribution consisting of income taxes payable on S Corporation earnings from January 1, 1998 through the date of termination of the Company's S Corporation status, and (ii) the Final S Corporation Distribution in an amount designed to be substantially all of the Company's remaining and undistributed accumulated S Corporation earnings through the date of termination of the Company's S Corporation status. The Company estimates that the amount of the Final Tax Distribution will be approximately \$7.0 million and the amount of the Final S Corporation Distribution will be approximately \$15.0 million and such amounts will be paid with a portion of the net proceeds of the Offering. See "Use of Proceeds." Purchasers of shares of Common Stock in the Offering will not receive any portion of the August Tax Distribution, the Final Tax Distribution or the Final S Corporation Distribution. On and after the date of such termination, the Company will no longer be treated as an S Corporation and, accordingly, will be fully subject to Federal and state income taxes. All pro forma income taxes reflect adjustments for Federal and state income taxes as if the Company had been taxed as a C Corporation rather than an S Corporation.

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## RESULTS OF OPERATIONS

The following table sets forth for the periods indicated, selected information from the Company's results of operations as a percentage of net sales. Pro forma reflects adjustments for federal and state income taxes as if the Company had been taxed as a C Corporation rather than an S Corporation.

<TABLE>  
<CAPTION>

	THREE MONTHS ENDED				
	YEAR ENDED DECEMBER 31,		MARCH 31,		
	1995	1996	1997	1997	1998
<S>	<C>	<C>	<C>	<C>	<C>
Net sales.....	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of sales.....	71.1	70.4	62.6	66.6	62.4
Gross profit.....	28.9	29.6	37.4	33.4	37.6
Royalty income, net.....	1.7	1.4	0.5	2.2	0.2
	30.6	31.0	37.9	35.6	37.8
Operating expenses:					
Selling.....	11.0	10.2	11.8	13.5	11.7
General and administrative.....	18.0	16.4	17.6	23.2	21.9
	29.0	26.6	29.4	36.7	33.6
Earnings (loss) from operations.....	1.6	4.4	8.5	(1.1)	4.2
Interest expense, net.....	(3.3)	(2.8)	(2.3)	(2.5)	(2.5)
Other, net.....	0.2	0.1	0.0	0.3	0.1
Earnings (loss) before pro forma income taxes (benefit) and extraordinary credit.....	(1.5)	1.7	6.2	(3.3)	1.8
Pro forma income taxes (benefit).....	(0.6)	0.7	2.5	(1.3)	0.7
Earnings (loss) before extraordinary credit... Extraordinary credit, net of pro forma income taxes.....	0.2	--	--	--	--
Pro forma net earnings (loss).....	(0.7%)	1.0%	3.7%	(2.0%)	1.1%

</TABLE>

### THREE MONTHS ENDED MARCH 31, 1998 COMPARED TO THREE MONTHS ENDED MARCH 31, 1997

#### Net Sales

Net sales increased \$32.3 million, or 117.0%, to \$59.9 million for the three months ended March 31, 1998 as compared to \$27.6 million for the three months ended March 31, 1997. This increase was due to increased sales of branded footwear primarily as a result of (i) greater brand awareness driven in part by a significant expansion of the Company's national marketing efforts, (ii) a broader breadth of men's, women's and children's product offerings, (iii) the development of the Company's domestic and international sales forces and (iv) the transition of the Company's account base in the direction of larger accounts with multiple stores and increased sales to such accounts, resulting in higher sales per account. Gross sales of men's footwear, including international, increased \$8.0 million, or 43.8%, to \$26.2 million for the three months ended March 31, 1998, as compared to \$18.2 million for the three months ended March 31, 1997. The increase in sales of men's footwear was achieved despite a decline in men's "Kani" footwear sales of \$3.6 million to \$598,000 for the three months ended March 31, 1998, as compared to \$4.2 million in sales for the three months ended March 31, 1997. The Company discontinued actively marketing "Kani" footwear in 1997. Sales of "Kani" footwear for the three months ended March 31, 1998 resulted from inventory close-outs, which were substantially completed during this fiscal period. Gross sales of women's footwear, including international, increased \$17.5 million, or 281.7%, to \$23.7 million for the three months ended March 31, 1998 as compared to \$6.2 million for the three months ended March 31, 1997. Gross sales of children's footwear, including international, increased \$3.8 million, or 127.5%, to \$6.9 million for the three months ended March 31, 1998 as compared to

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\$3.0 million for the three months ended March 31, 1997. Sales of children's "Kani" footwear represented \$20,000 and \$899,000 of such sales for the three months ended March 31, 1998 and 1997, respectively. Provisions for returns and allowances were \$1.6 million for the three months ended March 31, 1998 as compared to \$1.5 million for the three months ended March 31, 1997. Net sales through the Company's retail stores increased \$2.2 million, or 177.0%, to \$3.5 million for the three months ended March 31, 1998 as compared to \$1.3 million for the three months ended March 31, 1997. This increase is due to an increase in sales from pre-existing stores and new store openings. Net sales generated from international operations increased \$2.4 million, or 41.6%, to \$8.2 million for the three months ended March 31, 1998 as compared to \$5.8 million for the three months ended March 31, 1997.

#### Gross Profit

The Company's gross profit increased \$13.3 million, or 144.2%, to \$22.5 million for the three months ended March 31, 1998 compared to \$9.2 million for the three months ended March 31, 1997. The increase was attributable to higher sales and an improvement in gross profit as a percentage of net sales ("Gross Margin"). The Gross Margin increased to 37.6% for the three months ended March 31, 1998 from 33.4% for the same period in 1997. The increase in the Gross Margin was primarily due to (i) better retail sell-through at the Company's retail customer accounts, which typically results in fewer markdowns, (ii) an increase in the proportions of total sales derived from the women's and children's footwear line, which had a higher margin than the men's footwear line, (iii) the increase in the Company's retail store sales, since such retail gross margins are higher than customer retail gross margins as a percentage of net sales and (iv) decreased international sales as a percentage of net sales as international sales through distributors carry a lower Gross Margin.

#### Royalty Income

Royalty income decreased \$480,000, or 78.4%, to \$132,000 for the three months ended March 31, 1998 compared to \$612,000 for the three months ended March 31, 1997. The Company receives royalty income based upon a percentage of sales of its sublicensees. The decrease was due to the termination of the Company's license relating to "Kani" apparel. Royalty income attributable to sales of "Kani" apparel represented \$74,000 and \$735,000 of total royalty income for the three months ended March 31, 1998 and 1997, respectively. Management expects that royalty income may increase in total dollars, but not necessarily

as a percentage of net sales, as the Company's licensing efforts for Skechers products increase.

#### Selling Expenses

Selling expenses include sales salaries, commissions and incentives, advertising, promotions and trade shows. Selling expenses increased \$3.3 million, or 88.9%, to \$7.0 million (11.7% of net sales) for the three months ended March 31, 1998 from \$3.7 million (13.5% of net sales) for the three months ended March 31, 1997. The increase in total dollars was primarily due to increased advertising expenditures and sales compensation due to the increase in footwear sales, the implementation of a new sales compensation package and the hiring of additional sales personnel. The Company endeavors to spend approximately 8.0% of net sales in the marketing of Skechers footwear through advertising, promotions, public relations, trade shows and other marketing efforts. The decrease as a percentage of sales was due to the increase in footwear sales and the fixed cost nature of certain components of selling expenses.

#### General and Administrative Expenses

General and administrative expenses increased \$6.7 million, or 104.5%, to \$13.1 million (21.9% of net sales) for the three months ended March 31, 1998 from \$6.4 million (23.2% of net sales) for the three months ended March 31, 1997. The increase in total dollars is primarily due to (i) the hiring of additional personnel, (ii) an increase in costs associated with the Company's

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distribution facilities to support the Company's growth, (iii) increased product design and development costs and (iv) the addition of eight retail stores which were not open in the first quarter of 1997. The decrease as a percentage of net sales was primarily due to the increase in the volume of footwear sold. Also included in general and administrative expenses for the three months ended March 31, 1998 and 1997 are \$691,000 and \$142,000, respectively, of compensation expense relating to the Company's 1996 Incentive Compensation Plan (the "1996 Incentive Compensation Plan"). The Company expects to incur additional compensation expense for each quarter during the remainder of 1998 in connection with such Plan based upon the anticipated increase in net sales for 1998 over historical 1996 net sales levels. See "Management -- Executive Compensation -- 1996 Incentive Compensation Plan."

#### Interest Expense

Interest expense increased \$784,000, or 112.0%, to \$1.5 million for the three months ended March 31, 1998 as compared to \$700,000 for the three months ended March 31, 1997 as a result of increased borrowings under the Company's revolving line of credit to fund the Company's expanded operations and interest expense associated with open purchase agreements with the Company's Asian manufacturers, which in part finance the Company's manufacturing activities.

#### Income Taxes

Pro forma income taxes have been provided at the assumed rate of 40.0% for Federal and state purposes.

YEAR ENDED DECEMBER 31, 1997 COMPARED TO YEAR ENDED DECEMBER 31, 1996

#### Net Sales

Net sales increased \$68.4 million, or 59.3%, to \$183.8 million for the year ended December 31, 1997 from \$115.4 million for the year ended December 31, 1996. The increase was due to increased sales of branded footwear primarily as a result of (i) greater domestic brand awareness driven in part by a significant expansion of the Company's sales forces, (ii) a broad breadth of men's, women's and children's product offering, (iii) the development of the Company's domestic and international sales forces and (iv) the transition of the Company's account base in the direction of larger accounts with multiple stores, resulting in higher sales per account. Gross sales of men's footwear, including international, increased \$26.1 million, or 32.3%, to \$107.1 million for the year ended December 31, 1997 as compared to \$80.9 million for the year ended December 31, 1996. The increase in gross sales of men's footwear was achieved despite a decline in men's "Kani" footwear sales of \$2.2 million to \$11.5 million for the year ended December 31, 1997 as compared to \$13.7 million for the year ended

December 31, 1996. The Company discontinued actively marketing "Kani" footwear in 1997 and a substantial portion of sales of "Kani" footwear during 1997 consisted of inventory close-outs. The Company began to de-emphasize the sale of "Kani" footwear in late 1995 and early 1996 to concentrate its marketing and sales efforts on its Skechers product line. Gross sales of women's footwear, including international, increased \$25.1 million, or 101.3%, to \$49.9 million for the year ended December 31, 1997 as compared to \$24.8 million for the year ended December 31, 1996. Gross sales of children's footwear, including international, increased \$10.2 million, or 93.7%, to \$21.1 million for the year ended December 31, 1997 as compared to \$10.9 million for the year ended December 31, 1996. Sales of children's "Kani" footwear represented \$3.3 million and \$4.1 million of such sales for the years ended December 31, 1997 and 1996, respectively. Sales of children's "Kani" footwear in 1997 substantially represent inventory close-out sales. Provisions for returns and allowances were \$5.5 million for each of the years ended December 31, 1997 and 1996. Net sales through the Company's retail stores increased \$6.5 million, or 194.5%, to \$9.8 million for the year ended December 31, 1997 as compared to \$3.3 million for the year ended December 31, 1996. This increase is due to an increase in sales from pre-existing stores and new store openings. Net sales generated from international operations decreased \$3.9 million, or 12.2%, to \$27.7 million

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for the year ended December 31, 1997 as compared to \$31.6 million for the year ended December 31, 1996 largely as a result of a realignment of the Company's foreign distribution arrangements.

#### Gross Profit

Gross profit increased \$34.5 million, or 100.9%, to \$68.7 million for the year ended December 31, 1997 from \$34.2 million for the year ended December 31, 1996. The increase was attributable to higher sales and an improvement in the Gross Margin. The Gross Margin increased to 37.4% for the year ended December 31, 1997 from 29.6% for the year ended December 31, 1996. The increase in the Gross Margin was primarily due to (i) better retail sell-through at the Company's retail customer accounts which allowed for fewer markdowns, (ii) an increase in the proportion of total sales derived from the women's and children's footwear line, which had a higher margin than the men's footwear line, (iii) the increase in the Company's retail store sales and (iv) decreased international sales as a percentage of net sales as international sales through distributors carry a lower Gross Margin, offset in part by inventory close-out sales of "Kani" branded footwear.

#### Royalty Income

Royalty income decreased \$698,000, or 43.8%, to \$894,000 for the year ended December 31, 1997 from \$1.6 million for the year ended December 31, 1996. The decrease was due to decreased sales of apparel under the Company's "Kani" license. Royalty income attributed to sales of "Kani" apparel represented \$1.2 million and \$2.1 million of total royalty income for the years ended December 31, 1997 and 1996, respectively.

#### Selling Expenses

Selling expenses increased \$9.8 million, or 83.9%, to \$21.6 million (11.8% of net sales) for the year ended December 31, 1997 from \$11.7 million (10.2% of net sales) for the year ended December 31, 1996. The increase in total dollars was primarily due to increased advertising expenditures and sales commissions and incentives due to the increase in footwear sales. The increase as a percentage of sales was due to increased advertising expenses on a percentage of net sales.

#### General and Administrative Expenses

General and administrative expenses increased \$13.5 million, or 71.1%, to \$32.4 million (17.6% of net sales) for the year ended December 31, 1997 as compared to \$18.9 million (16.4% of net sales) for the year ended December 31, 1996. The increase in total dollars was primarily due to (i) the hiring of additional personnel and related costs to support the Company's substantial growth in sales, (ii) an increase in costs associated with the Company's distribution facilities to support the Company's growth, (iii) the addition of seven retail stores which were not open in 1996, (iv) increased product design and development costs and (v) compensation expense of \$1.7 million related to

the Company's 1996 Incentive Compensation Plan. See "Management -- Executive Compensation -- 1996 Incentive Compensation Plan." Included in the \$18.9 million of general and administrative expenses for 1996 is a one-time \$530,000 charge to operations related to costs of the terminated public offering of the "Kani" division. The increase in general and administrative expenses as a percentage of net sales is attributable to the \$1.7 million of compensation expense relating to the Company's 1996 Incentive Compensation Plan.

#### Interest Expense

Interest expense increased \$955,000, or 29.6%, to \$4.2 million for the year ended December 31, 1997 as compared to \$3.2 million for the year ended December 31, 1996 as a result of increased borrowings under the Company's revolving line of credit to fund the Company's expanded

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operations and interest expense associated with open purchase agreements with the Company's Asian manufacturers.

#### Income Taxes

Pro forma income taxes have been provided at the assumed rate of 40.0% for Federal and state purposes.

### YEAR ENDED DECEMBER 31, 1996 COMPARED TO YEAR ENDED DECEMBER 31, 1995

#### Net Sales

Net sales increased \$4.8 million, or 4.3%, to \$115.4 million for the year ended December 31, 1996 from \$110.6 million for the year ended December 31, 1995. Net sales in 1995 and 1996 were adversely affected as the Company repositioned its product offerings. In late 1995, the Company de-emphasized the sale of men's and children's footwear under the "Kani" brand and discontinued offering men's and children's footwear under the "Cross Colours" brand and women's footwear under the "So . . . L.A." brand to concentrate its marketing and sales efforts on its Skechers product line. Gross sales of men's footwear, including international, decreased \$11.9 million, or 12.8%, to \$80.9 million for the year ended December 31, 1996 as compared to \$92.8 million for the year ended December 31, 1995. Sales of men's "Kani" footwear represented \$13.7 million and \$15.9 million of such sales for the years ended December 31, 1996 and 1995, respectively, while sales of men's "Cross Colours" footwear represented \$209,000 and \$3.4 million of such sales for the comparable years. In 1996, gross sales of footwear were adversely affected by decreased consumer demand for a style of footwear which represented \$16.4 million, or 18.3%, of the Company's sales of men's footwear net of discounts, in 1995, which declined to \$4.7 million, or 5.8%, of the Company's sales of men's footwear net of discounts, in 1996. Men's sales were stronger in the second half of 1996 as the Company completed its repositioning efforts. Gross sales of women's footwear, including international, increased \$9.7 million, or 64.7%, to \$24.8 million for the year ended December 31, 1996 as compared to \$15.1 million for the year ended December 31, 1995. Of the \$15.1 million for the year ended December 31, 1995, \$2.1 million was represented by sales of "So . . . L.A." footwear which was discontinued during 1995. Gross sales of children's footwear, including international, increased \$3.0 million, or 38.0%, to \$10.9 million for the year ended December 31, 1996 as compared to \$7.9 million for the year ended December 31, 1995. Sales of children's "Kani" footwear represented \$4.1 million and \$3.0 million of sales of children's footwear for the years ended December 31, 1996 and 1995, respectively, while sales of children's "Cross Colours" footwear represented \$160,000 of such sales for 1995 and were discontinued during that year. Provisions for returns and allowances were \$5.5 million for the year ended December 31, 1996 as compared to \$7.0 million for the year ended December 31, 1995. Net sales through the Company's retail stores increased \$3.0 million, or 798.5%, to \$3.3 million for the year ended December 31, 1996 as compared to \$371,000 for the year ended December 31, 1995. This increase is due to increased sales from the pre-existing store and new store openings. Net sales from international operations increased \$9.2 million, or 41.3%, to \$31.6 million for 1996 as compared to \$22.4 million for 1995 due to the expansion of the Company's international distribution network.

#### Gross Profit

Gross profit increased \$2.3 million, or 7.1%, to \$34.2 million for the year

ended December 31, 1996 as compared to \$32.0 million for the year ended December 31, 1995. The Gross Margin increased to 29.6% for the year ended December 31, 1996 as compared to 28.9% for the year ended December 31, 1995. The increase in the Gross Margin was primarily due to (i) increased sales of Skechers products in the second half of 1996, (ii) the absence of substantial close-out sales of "Cross Colours" and "So . . . L.A." brands in 1996 which adversely affected the Gross Margin in 1995 and (iii) the increase in the Company's retail store sales, offset in part by increased international

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sales as a percentage of net sales as international sales through distributors carry a lower Gross Margin.

#### Royalty Income

Royalty income decreased \$251,000, or 13.6%, to \$1.6 million for the year ended December 31, 1996 as compared to \$1.8 million for the year ended December 31, 1995 primarily as a result of decreased sales of apparel under the Company's "Kani" license. Royalty income attributed to sales of "Kani" apparel represented \$2.1 million and \$1.3 million of total royalty income for the year ended December 31, 1996 and 1995, respectively.

#### Selling Expenses

Selling expenses decreased \$411,000, or 3.4%, to \$11.7 million (10.2% of net sales) for the year ended December 31, 1996 as compared to \$12.2 million (11.0% of net sales) for the year ended December 31, 1995. The decrease in total dollars and as a percentage of net sales was primarily due to lower trade show expenses.

#### General and Administrative Expenses

General and administrative expenses decreased \$911,000, or 4.6%, to \$18.9 million (16.4% of net sales) for the year ended December 31, 1996 as compared to \$19.9 million (18.0% of net sales) for the year ended December 31, 1995. The decrease in total dollars and as a percentage of net sales was primarily due to lower professional fees and travel and entertainment expenses. Included in the \$18.9 million of general and administrative expenses for 1996 is a \$530,000 charge to operations related to costs of the terminated public offering of the "Kani" division.

#### Interest Expense

Interest expense decreased \$445,000, or 12.1%, to \$3.2 million for the year ended December 31, 1996 as compared to \$3.7 million for the year ended December 31, 1995 as a result of lower borrowings under the Company's revolving line of credit.

#### Extraordinary Credit

In June 1995, the Company accelerated payment on a promissory note for the purchase of rights to the "Kani" trademarks, in exchange for relief of \$450,000 of a promissory note liability. The Company recorded this relief of debt as an extraordinary credit, net of \$7,000 of related income taxes.

#### Income Taxes

Pro forma income taxes have been provided at the assumed rate of 40.0% for Federal and state purposes.

### LIQUIDITY AND CAPITAL RESOURCES

To date, the Company has relied upon internally generated funds, trade credit, borrowings under credit facilities and loans from stockholders to finance its operations and expansion. The Company's need for funds arises primarily from its working capital requirements, including the need to finance its inventory and receivables. The Company's working capital was \$17.2 million at March 31, 1998 and was \$17.1 million, \$12.0 million and \$8.2 million at December 31, 1997, 1996 and 1995, respectively. The increase in working capital at March 31, 1998 and December 31, 1997 was primarily due to increases in receivables and inventories due to seasonal requirements and the need to support additional Company retail stores. Inventory at March 31, 1998 and December 31,

1997, 1996 and 1995 was \$47.8 million, \$45.8 million, \$15.8 million and \$23.6 million, respectively.

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Trade accounts receivable, net of reserves, at March 31, 1998 and at December 31, 1997, 1996 and 1995 were \$35.2 million, \$31.2 million, \$19.7 million and \$15.6 million, respectively. Trade accounts receivable increases reflect the higher level of footwear sales. Inventory levels in 1996 were affected as a result of sell-offs of inventory in connection with the Company's repositioning strategy to de-emphasize its "Kani" brand and discontinue its "Cross Colours" and "So . . . L.A." brands of footwear to concentrate its marketing and sales efforts on its Skechers product line. Substantially all of the "Kani" inventory had been liquidated as of March 31, 1998. Inventory increased in 1997 due to advance customers orders for 1998. The Company anticipates that inventory levels will continue to increase as the Company expands its business and continues to increase its in-stock inventory program. Such inventory increases are expected to be financed with borrowings under the Company's revolving line of credit. The increased inventories may result in an increased risk of inventory obsolescence and potential material increased markdowns which could adversely affect the Gross Margin.

As part of the Company's working capital management, the Company performs substantially all customer credit functions internally, including extension of credit and collections. The Company's bad debt write-offs were less than 1.0% of net sales for each of the three months ended March 31, 1998 and the years ended December 31, 1997, 1996 and 1995. The Company carries bad debt insurance to cover approximately the first 90.0% of bad debts on substantially all of the Company's major retail accounts. As of March 31, 1998 and December 31, 1997 and 1996, 42.3%, 47.1% and 33.2% of the Company's accounts receivables were generated by accounts covered under this insurance, respectively.

Net cash provided by (used in) operating activities totaled \$(24.3) million and \$11,000 for the three months ended March 31, 1998 and 1997, respectively, and \$(2.1) million, \$6.6 million and \$(1.4) million for the years ended December 31, 1997, 1996 and 1995, respectively. The decrease of cash provided by operating activities for the three months ended March 31, 1998 and the year ended December 31, 1997 as compared to the comparable prior year fiscal periods was due to an increase in trade accounts receivable and inventory balances. The decrease in cash used in operations from 1995 to 1996 was due to a reduction of inventory levels primarily related to close-out sales of discontinued product lines.

Net cash used in investing activities was \$1.2 million and \$327,000 for the three months ended March 31, 1998 and 1997, respectively, and was \$6.7 million, \$829,000 and \$1.8 million for the years ended December 31, 1997, 1996 and 1995, respectively. The increase in net cash used in investing activities in 1997 was primarily due to increased capital expenditures in connection with the establishment of the Company's distribution facility in Ontario, California, additional hardware and software for the Company's computer needs and additional Company retail stores.

Capital expenditures totaled \$1.2 million, \$6.2 million, \$630,000 and \$1.5 million for the three months ended March 31, 1998 and the years ended December 31, 1997, 1996 and 1995, respectively. The increase in 1997 relates primarily to the establishment of the Company's distribution center in Ontario, California, the purchase of additional hardware and software for the Company's computer needs and additional Company retail stores. Capital expenditures for the three months ended March 31, 1998 primarily represents property and equipment additions associated with new Company retail stores. The Company estimates that its capital expenditures for the remainder of 1998 will be approximately \$6.0 million. Included in this amount is a portion of the approximately \$10.0 million expected to be spent in connection with the installation of a new material handling system in the Company's new distribution facility. The balance of capital expenditures for 1998 will be primarily used for additional retail stores, to enhance the Company's trade show booths and to update the Company's electronic data interchange ("EDI") system. It is expected that the addition of each new retail store will entail capital expenditures for furniture, fixtures and equipment of approximately \$150,000.

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Net cash provided by (used in) financing activities was \$24.4 million and



\$163,000 for the three months ended March 31, 1998 and 1997, respectively, and was \$10.2 million, \$(5.6) million and \$3.2 million for the years ended December 31, 1997, 1996 and 1995, respectively. The increase in net cash provided by financing activities in 1997 was due to the issuance of a term note to finance capital expenditures and increased borrowings under the Company's revolving line of credit to finance capital expenditures, increased accounts receivables and inventories and to fund S Corporation distributions. Cash levels in 1996 were primarily affected by a reduction in inventory levels and increased borrowings from the Company's principal stockholder.

The Company's credit facility was amended in June 1998 to provide for borrowings under a revolving line of credit of up to \$120.0 million and two term loans, with actual borrowings limited to available collateral and certain limitations on total indebtedness (approximately \$79.9 million of availability as of June 30, 1998) from Heller Financial, Inc. The revolving line of credit bears interest at the Company's option at either the prime rate (8.50% at June 30, 1998) plus 25 basis points or at Libor plus 2.75%; the Company has elected to designate the Libor rate. The revolving line of credit expires on December 31, 2002. Interest on the revolving line of credit is payable monthly in arrears. The revolving line of credit provides a sub-limit for letters of credit of up to \$18.0 million to finance the Company's foreign purchases of merchandise inventory. As of June 30, 1998, the Company had approximately \$3.8 million of letters of credit under the revolving line of credit. One term note component of the credit facility, which has a principal balance of approximately \$2.8 million as of June 30, 1998, bears interest at the prime rate plus 100 basis points and is due in monthly installments with a final balloon payment December 2002. The proceeds from this note were used to purchase equipment for the Company's distribution center in Ontario, California and the note is secured by such equipment. A second term note is guaranteed by the Greenberg Family Trust, bears interest at the prime rate plus 25 basis points and is due at the earlier of June 1999 or the closing of the Offering. Such guaranty is collateralized by cash equal to the principal amount of the note. As of June 30, 1998, approximately \$13.3 million was outstanding under this second term note, the proceeds from which were used in June 1998 to repay the Stockholder Note in the principal amount of approximately \$13.3 million. The Company intends to use a portion of the net proceeds of the Offering to repay approximately \$55.7 million under the revolving line of credit and \$13.3 million outstanding under the second term note. See "Use of Proceeds." By repaying such indebtedness, the Company expects to have more flexibility and liquidity to pursue its growth strategies. As of March 31, 1998, the Stockholder Note bore interest at 8.0% and was due on demand. The stockholder agreed not to require repayment of the Stockholder Note until January 1999. The Company recorded interest expense of approximately \$275,000, \$1.1 million, \$1.2 million and \$944,000 related to the Stockholder Note during the three months ended March 31, 1998 and the years ended December 31, 1997, 1996 and 1995, respectively. The credit facility contains certain financial covenants that require the Company to maintain specified minimum tangible net worth, working capital and leverage ratios and limit the ability of the Company to pay dividends if it is in default of any provisions of the credit facility. The Company was in compliance with these covenants as of March 31, 1998. The credit facility is collateralized by the Company's real and personal property, including, among other things, accounts receivable, inventory, general intangibles and equipment.

By reason of the Company's treatment as an S Corporation for Federal and state income tax purposes, the Company since inception has provided to its stockholders funds for the payment of income taxes on the earnings of the Company. The Company distributed amounts attributable to payment of such taxes of \$3.2 million, \$112,000 and \$170,000 in 1997, 1996 and 1995, respectively. In August 1998, the Company will declare the August Tax Distribution, estimated to be \$3.6 million, and upon consummation of the Offering will declare the Final Tax Distribution, estimated to be \$7.0 million, and the Final S Corporation Distribution, estimated to be \$15.0 million. Following the termination of the Company's S Corporation status, earnings will be retained for the foreseeable future in the operations of the business. See "Prior S Corporation Status" and "Dividend Policy."

The Company believes that anticipated cash flows from operations, available borrowings under the Company's revolving line of credit, after repayment of indebtedness described under "Use of Proceeds," and its financing arrangements will be sufficient to provide the Company with the liquidity necessary to fund its anticipated working capital and capital requirements through fiscal 1999.

However, in connection with its growth strategy, the Company will incur significant working capital requirements and capital expenditures. The Company's future capital requirements will depend on many factors, including, but not limited to, the levels at which the Company maintains inventory, the market acceptance of the Company's footwear, the levels of promotion and advertising required to promote its footwear, the extent to which the Company invests in new product design and improvements to its existing product design and the number and timing of new store openings. To the extent that available funds are insufficient to fund the Company's future activities, the Company may need to raise additional funds through public or private financing. No assurance can be given that additional financing will be available or that, if available, it can be obtained on terms favorable to the Company and its stockholders. Failure to obtain such financing could delay or prevent the Company's planned expansion, which could adversely affect the Company's business, financial condition and results of operations. In addition, if additional capital is raised through the sale of additional equity or convertible securities, dilution to the Company's stockholders could occur. See "Use of Proceeds."

#### QUARTERLY RESULTS AND SEASONALITY

The table below sets forth quarterly operating data of the Company for the third and fourth quarters of 1996 and each of the four quarters of 1997 and the first quarter of 1998. This quarterly information is unaudited, but in management's opinion reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the information for the periods presented when read in conjunction with the financial statements of the Company and notes thereto.

<TABLE>  
<CAPTION>

	1996		1997			1998		
	SEPTEMBER 30	DECEMBER 31	MARCH 31	JUNE 30	SEPTEMBER 30	DECEMBER 31	MARCH 31	
THREE MONTHS ENDED	(IN THOUSANDS)							
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	
Net sales.....	\$39,277	\$32,582	\$27,591	\$32,705	\$62,562	\$60,969	\$59,873	
Gross profit.....	12,377	11,017	9,207	11,125	23,552	24,839	22,483	
Earnings (loss) from operations.....	4,854	2,877	(299)	2,244	8,203	5,488	2,505	
Pro forma net earnings (loss).....	2,393	919	(559)	760	4,278	2,369	651	

Sales of footwear products are somewhat seasonal in nature with the strongest sales generally occurring in the third and fourth quarters. In 1997, 34.0% of net sales and 52.5% of earnings from operations were generated in the third quarter and 33.2% of net sales and 35.1% of earnings from operations were generated in the fourth quarter. The Company has experienced, and expects to continue to experience, variability in its net sales, operating results and net earnings, on a quarterly basis. The Company's domestic customers generally assume responsibility for scheduling pickup and delivery of purchased products. Any delay in scheduling or pickup which is beyond the Company's control could materially negatively impact the Company's net sales and results of operations for any given quarter. The Company believes the factors which influence this variability include (i) the timing of the Company's introduction of new footwear products, (ii) the level of consumer acceptance of new and existing products, (iii) general economic and industry conditions that affect consumer spending and retail purchasing, (iv) the timing of the placement, cancellation or pickup of customer orders, (v) increases in the number of employees and overhead to support growth, (vi) the timing of expenditures in anticipation of increased sales and customer delivery requirements, (vii) the number and timing of new Company retail store openings and (viii) actions by competitors. Due to these and other factors, the operating results for any particular quarter are not necessarily indicative of the results for the full year.

#### INFLATION

The Company does not believe that the relatively moderate rates of inflation experienced in the United States over the last three years have had a significant effect on its net sales or profitability. However, the Company

cannot accurately predict the effect of inflation on future operating results. Although higher rates of inflation have been experienced in a number of foreign countries in which the Company's products are manufactured, the Company does not believe that inflation has had a material effect on the Company's net sales or profitability. In the past, the Company has been able to offset its foreign product cost increases by increasing prices or changing suppliers, although no assurance can be given that the Company will be able to continue to make such increases or changes in the future.

#### EXCHANGE RATES

The Company receives U.S. Dollars for substantially all of its product sales and its royalty income. Inventory purchases from offshore contract manufacturers are primarily denominated in U.S. Dollars; however, purchase prices for the Company's products may be impacted by fluctuations in the exchange rate between the U.S. Dollar and the local currencies of the contract manufacturers, which may have the effect of increasing the Company's cost of goods in the future. During 1996 and 1997 and the three months ended March 31, 1998, exchange rate fluctuations have not had a material impact on the Company's inventory costs. The Company does not engage in hedging activities with respect to such exchange rate risk. See "Risk Factors -- Risks Associated with Foreign Operations."

#### YEAR 2000 COMPLIANCE

The Company is assessing the internal readiness of its computer systems for handling the year 2000 issue. The Company expects to implement the systems and programming changes necessary to address year 2000 issues with respect to its internal systems and does not believe that the cost of such actions will have a material adverse effect on its business, financial condition and results of operations. Although the Company is not aware of any material operational issues or costs associated with preparing its internal systems for the year 2000, there can be no assurance that there will not be a delay in, or increased costs associated with, the implementation of the necessary systems and changes to address the year 2000 issues, and the Company's inability to implement such systems and changes in a timely manner could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company also relies, directly and indirectly, on external systems of business enterprises such as third party manufacturers and suppliers, customers, creditors and financial organizations, and of governmental entities, both domestic and international, for accurate exchange of data. Even if the internal systems of the Company are not materially affected by the year 2000 issue, the Company could be affected by disruptions in the operation of the enterprises with which the Company interacts. Despite the Company's efforts to address the year 2000 impact on its internal systems and business operations, there can be no assurance that such impact will not result in a material disruption of its business or have a material adverse effect on the Company's business, financial condition and results of operations.

#### RECENT ACCOUNTING PRONOUNCEMENTS

Effective January 1, 1998, the Company adopted Statement of Financial Accounting Standards "SFAS" No. 130, Reporting Comprehensive Income ("SFAS No. 130"). SFAS No. 130 establishes standards to measure all changes in equity that result from transactions and other economic events other than transactions with owners. Comprehensive income is the total of net earnings and all other non-owner changes in equity. Except for net earnings, the Company does not have any transactions and other economic events that qualify as comprehensive income as defined under SFAS No. 130.

In 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information ("SFAS No. 131"). SFAS No. 131 introduces a new model for segment reporting called the "management approach." The management approach is based on the manner in which management organizes segments within a company for making operating decisions and assessing performance. The management approach replaces the notion of industry and geographic segments. SFAS No. 131 is effective for the Company as of January 1, 1998; however, in accordance with SFAS 131, this statement has not been applied for interim periods in the initial year of application but will be adopted as of December 31, 1998.

The Company believes the adoption of SFAS No. 130 and SFAS No. 131 will not significantly affect the Company's financial position, results of operations or financial statement presentation.

In June 1998, the FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS No. 133"). SFAS No. 133 modifies the accounting for derivative and hedging activities and is effective for fiscal years beginning after December 15, 1999. Since the Company does not presently invest in derivatives or engage in hedging activities, SFAS No. 133 will not impact the Company's financial position or results of operations.

In March 1998, the American Institute of Certified Public Accountants issued Statement of Position 98-1 ("SOP 98-1"), Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. The Company will adopt SOP 98-1 effective in 1999. The adoption of SOP 98-1 will require the Company to modify its method of accounting for software. Based on information currently available, the Company does not expect the adoption of SOP 98-1 to have a significant impact on its financial position or results of operations.

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## BUSINESS

The following Business section contains forward-looking statements which involve risks and uncertainties including, but not limited to, information with regard to the Company's plans to increase the number of retail locations, and styles of footwear, the maintenance of customer accounts and expansion of business with such accounts, the successful implementation of the Company's strategies, future growth and growth rates and future increases in net sales, expenses, capital expenditures and net earnings. The words "believes," "anticipates," "plans," "expects," "may," "will," "intends," "estimates," and similar expressions are intended to identify forward-looking statements. These forward-looking Statements involve risks and uncertainties, and the Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under "Risk Factors" and elsewhere in this Prospectus.

## GENERAL

Skechers designs and markets branded contemporary casual, active, rugged and lifestyle footwear for men, women and children. The Company's objective is to become the premier source of contemporary casual and active footwear while ensuring the longevity of both the Company and the Skechers brand name through controlled, well managed growth. The Company strives to achieve this objective by developing and offering a balanced assortment of basic and fashionable merchandise across a wide spectrum of product categories and styles, while maintaining a diversified, low-cost sourcing base and controlling the growth of its distribution channels. The Company sells its products to department stores such as Nordstrom, Macy's, Dillard's, Robinson's-May and JC Penney and specialty retailers such as Genesco's Journeys and Jarman chains, The Venator Group's Foot Locker and Lady Foot Locker chains, Pacific Sunwear and Florsheim. The Company also sells its products both internationally in over 120 countries and territories through major international distributors and directly to consumers through 26 of its own retail stores.

The Company has realized rapid growth since inception, increasing net sales from \$42.7 million in 1993 to \$183.8 million in 1997. From 1996 to 1997, the Company experienced a 59.3% and 205.1% increase in net sales and earnings from operations, respectively. The Company also experienced an improvement in gross profit as a percentage of net sales from 29.6% to 37.4% and in earnings from operations as a percentage of net sales from 4.4% to 8.5% over this same period, resulting in part from the shift to offering Skechers product exclusively and in part from economies of scale. For the quarter ended March 31, 1998, the Company realized a 117.0% increase in net sales compared to the comparable period from the prior year while increasing gross profit as a percentage of net sales from 33.4% to 37.6%. In 1998, the Company achieved profitability in the first calendar quarter for the first time in its history, a fiscal period which is typically adversely affected by seasonal fluctuations.

Management believes the Skechers product offerings of men's, women's and children's footwear appeal to a broad customer base between the ages of 5 and 40 years. Management believes the Company's strategy of providing a growing and

balanced assortment of quality basic footwear and seasonal and fashion footwear with progressive styling at competitive prices gives Skechers this broader based customer appeal. Skechers men's and women's footwear are primarily designed with the active, youthful lifestyle of the 12 to 25 year old age group in mind. The Company's product offering includes casual and utility oxfords, loggers, boots and demi-boots; skate, street and fashion sneakers; hikers, trail runners and joggers; sandals, slides and other open-toe footwear; and dress casual shoes. The Company continually seeks to increase the number of styles offered and the breadth of categories with which the Skechers brand name is identified. This style expansion and category diversification is balanced by the Company's strong performance in its basic styles. The Company increased its styles offered from approximately 390 for the three months ended March 31, 1997 to approximately 600 for the three months ended March 31, 1998. For the three months ended March 31, 1998, approximately 54.0% of the Company's gross sales of men's style footwear were

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generated from basic styles that have been in the Company's line for at least three seasons. Management's goal is to achieve a comparable portion of gross sales of its women's and children's lines in its basic styles with sufficient operating history. The Company's women's and children's lines have only recently been expanded and emphasized, and many styles within these lines have only recently been introduced.

The Company's strategy in children's footwear is to adapt current fashion from the Company's men's and women's lines by modifying designs and choosing colors and materials that are more suitable to the playful image Skechers has established in the children's footwear market. The Skechers children's line is comprised primarily of shoes that are designed like their adult counterparts but in "takedown" versions, so that the younger set can wear the same popular styles as their older siblings and schoolmates. The playful image of Skechers children's footwear is further enhanced by the Company's Skechers Lights line, which features motion- and contact-activated lights in the outsole and other areas of the shoes. During 1997, the Company's gross footwear sales were derived 60.4% from men's, 27.8% from women's and 11.8% from children's footwear.

The Company was founded in 1992 as a distributor of Dr. Martens footwear. The Company began designing and marketing men's footwear under the Skechers brand name and other brand names including "Cross Colours," "Karl Kani" and "So . . . L.A." in 1993. Shortly after launching these branded footwear lines, the Company discontinued distributing Dr. Martens footwear. In 1995, the Company began to shift its focus to the Skechers brand name by de-emphasizing the sale of "Kani" branded products and discontinuing the sale of "Cross Colours" and "So . . . L.A." branded footwear. In early 1996, the Company substantially increased its product offerings in and marketing focus on its Skechers women's and children's lines. The Company divested the "Karl Kani" license in August 1997. Substantially all of the Company's products are marketed under the Skechers name.

## INDUSTRY OVERVIEW

The Company competes in the men's, women's and children's markets for casual and rugged footwear. According to published industry sources, domestic retail sales of men's and women's footwear in dollar volume were roughly equal in 1996, representing approximately 45.3% and 44.2% of the retail footwear market, respectively. The remaining 10.5% was comprised of children's footwear. However, unit volume was skewed more heavily toward women's and children's footwear, which represented 52.1% and 18.7%, of the total units sold at retail, respectively. Men's footwear represented 29.2% of total units sold at retail in 1996. Average industry price points for men's, women's and children's footwear were approximately \$53.37, \$29.21 and \$19.40, respectively.

According to published industry sources, total retail footwear sales in the United States during 1996 were approximately \$36.8 billion, representing a 3.4% increase over 1995. Of that total, approximately \$19.7 billion, or 53.5%, was derived from sales of casual and rugged shoes, boots and sandals, including hiking and working boots. Casual footwear retail sales increased to \$17.7 billion, or 6.6%, in 1996 from \$16.6 billion in 1995, or nearly twice the rate of the total footwear market. Rugged footwear retail sales increased 17.6% to \$2.0 billion in 1996 from \$1.7 billion in 1995 and has grown at a compound annual rate of 30.0% since 1992. Together, these two categories are projected to continue to outpace the overall footwear market, growing at a combined compound annual rate of 7.1% between 1996 and 2001 compared to overall annual industry

growth of 4.0%. By 2001, casual and rugged footwear retail sales are projected to reach \$27.7 billion, or approximately 61.8% of the total retail footwear market.

Retail sales of performance athletic footwear by comparison has grown at a compound annual rate of 3.1% from 1992 to 1996 but rose only 2.6% from \$11.8 billion in 1995 to \$12.1 billion in 1996. Industry sources indicate that the growth of the performance athletic shoe segment is expected to continue to slow and underperform the overall footwear market, growing only 2.4% per year between 1996 and 2001. Retail sales of dress footwear declined 9.1%, from \$5.5 billion in 1995

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to \$5.0 billion in 1996, and is expected to continue to decline at a compound annual rate of 8.6% to \$3.5 billion by 2001.

Management believes that the shift to casual and rugged footwear from dress shoes and, to a lesser extent, from performance athletic shoes is a result of several factors. First, management believes that the widespread acceptance of casual dress in the workplace has had a substantial impact on footwear purchasing decisions. As this acceptance has spread from casual Fridays to the entire work week, its impact has increased. Second, according to published industry sources, approximately 80.0% of all athletic footwear purchased in 1996 was worn for fashion instead of athletic performance purposes. Management believes that the use of athletic footwear for non-athletic performance purposes has diminished and that the casual and rugged footwear segment is eroding the market share this 80.0% portion has historically commanded, particularly as specialty retailers such as Foot Locker, Foot Action, Finish Line and Athlete's Foot, which have traditionally focused on athletic footwear, increase their selections of casual and rugged footwear. Management believes that a recent increase in the popularity of and marketing emphasis on khaki pants among consumers and apparel companies, respectively, has accelerated and magnified the fashion shift from performance athletic to casual and rugged footwear. Third, management believes that the advent of alternative sports, which do not require traditional athletic footwear for competition, has propelled a cultural movement among teenagers and a shift in their cultural icons that have combined to generate a trend toward alternative footwear. According to published industry sources, approximately 14.5 million people currently participate in alternative or extreme sports. Participation rates are projected to increase to approximately 25.0 million by 2001.

According to the U.S. Bureau of the Census, the 12 to 25 year old age segment of the population was approximately 51.4 million people, or 19.2% of the total population, in 1997. This age group is projected to grow approximately 70.2% faster than the total U.S. population, from 1997 until 2005, when these young consumers will represent approximately 20.1% of the U.S. population. 12 to 25 year olds are expected to reach approximately 59.7 million people in 2015. The U.S. Bureau of the Census also estimates that 15 to 24 year olds generated incomes of approximately \$244.3 billion in 1995, excluding gifts, allowances and other funding from family members. According to published industry sources, teen spending increased 29% from 1993 to approximately \$111.0 billion in 1997. In 1996 approximately \$7.7 billion, or 7.1%, of total expenditures, was spent on footwear. According to published industry sources, brand is an important consideration in purchasing decisions among this age group, with 86% of female shoppers and 81% of male shoppers willing to spend more money for a brand they prefer. The influence of branding becomes apparent on consumers as young as 15 years old. Total spending by teenagers is expected to reach approximately \$135.9 billion by 2001.

Management believes that this growing demographic is an important target market within the footwear industry as a whole and within the casual and rugged segment of that industry in particular. Management also believes that teenagers and young adults set the prevailing fashion trends of their time and that these fashion trends are generally widely accepted by older and younger consumers alike in one form or another.

## OPERATING STRATEGIES

The Company's operating strategies are intended to continue to differentiate the Company from other participants in the casual footwear market and to provide controlled, well-managed growth. These strategies are as follows.

Offer a Breadth of Innovative Products. The Company produces approximately 600 different styles of footwear generally in three to four different color and material variations typically in 10 to 12 different sizes. These styles span a broad spectrum of product categories ranging from skate and street sneakers to fashion sneakers, from steel-toe boots with heavy-lugged soles to casual dress shoes for men, from hiking boots, trail runners and joggers to platform shoes, boots and sneakers.

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The Company has developed this breadth of merchandise offerings in an effort to improve its ability to respond to changing fashion trends and customer preferences, as well as to limit its exposure to any single industry participant. Management does not believe that any single industry participant competes directly with the Company across its entire product offering. Although major new product introductions take place in advance of both the spring and fall selling seasons, the Company typically introduces new designs in its existing lines every 30 to 60 days to keep current with emerging trends.

All of the Company's footwear is designed with an active, youthful lifestyle in mind. The design team's primary mandate is to design shoes marketable to the 12 to 25 year old consumer. While these designs are contemporary in styling, management believes that substantially all of the line appeals to the broader 5 to 40 year old consumer. Although many of the Company's shoes have performance features, such as hikers, trail runners, skate sneakers and joggers, the Company generally does not position its shoes in the marketplace as technical performance shoes. The Company's principal goal in product design is to generate new and exciting footwear with contemporary and progressive style features and comfort enhancing performance features. Management does not believe that technology is a differentiating factor in marketing footwear in the casual shoe industry.

Enhance and Broaden the Skechers Brand Name. Management believes that the strength of the Skechers brand name is a competitive advantage and an integral part of the Company's success to date. The Company's goal is to continue to build the recognition of the Skechers name as a casual, active, youthful lifestyle brand that stands for quality, comfort, durability and design innovation. The Company's in-house marketing and advertising team has developed a comprehensive program to promote the Skechers brand name through lifestyle and image advertising. While all advertisements feature the Company's footwear, the marketing program is image driven, not product specific. The Company has made a conscious effort to avoid the association of the Skechers name with any single category of shoe to provide merchandise flexibility and to aid management's ability to take the brand and product design in the direction of evolving footwear fashions and consumer preferences. The Company supports this image through an advertising program that includes major networks and cable channels such as MTV, Nickelodeon and ESPN, as well as print advertisements in popular fashion and lifestyle consumer publications such as Spin, Details, Seventeen, Rolling Stone, Vibe, GQ and Vogue.

The Company also employs an aggressive point-of-purchase marketing campaign which includes signage and, in many cases, "in-store shops" within specialty retail stores and certain department stores. These in-store shops and visual merchandising of the Company's product and point-of-purchase marketing materials are monitored and maintained by the Company's field service representatives. Substantially all of the Company advertising is conceived and designed by its in-house staff of graphic designers. The Company also enhances its brand image with its customers through high-profile trade show presentations that feature fast-paced stage shows set to progressive dance and hip-hop music.

Maximize Strategic Value of Retail Distribution. The Company operates 14 concept stores at marquee locations in major metropolitan cities. These concept stores serve a threefold purpose in the Company's operating strategy. First, concept stores serve as a showcase for the full range of the Company's product offerings for the current season, providing the customer with the entire product story. In contrast, management estimates that its average retail customer carries no more than 5.0% of the complete Skechers line. Second, retail locations are generally chosen to generate maximum marketing value for the Skechers brand name through signage and store front presentation. These locations include concept stores in Manhattan's Times Square and Santa Monica's Third Street Promenade. Third, the concept stores provide rapid product feedback. Management believes that product sell-through information derived from the Company's concept stores enables the Company's sales, merchandising and

production staff to respond to market changes and new product introductions. Such responses serve to augment sales and limit the Company's inventory markdowns and

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customer returns and allowances. Management adjusts its product and sales strategy based upon seven to 14 days of retail sales information. The Company's concept stores serve as marketing and product testing venues. Each of the Company's concept stores that were open for a full quarter made a positive contribution to earnings in 1997. The Company also operates 12 factory and warehouse outlet stores that enable the Company to liquidate excess, discontinued and odd-size inventory in a cost-efficient manner. Inventory in these stores is supplemented by certain first-line styles sold at full retail price points generally of \$60.00 or lower. Each of the outlet stores that were opened for a full quarter made a positive contribution to earnings in 1997.

**Control Growth of Distribution Channels.** Management has implemented a strategy of controlling the growth of the distribution channels through which the Company's products are sold in order to protect the Skechers brand name, properly service customer accounts and better manage the growth of the business. The Company has limited distribution of product to those retailers which management believes can best support the Skechers brand name in the market. In April 1998, the Company made the decision to discontinue opening new accounts through December 1998. Although the Company does intend to open new customer accounts in the future, management believes that by focusing on the Company's existing accounts, the Company can deepen its relationships with its existing customers by providing a heightened level of customer service. Field service representatives work closely with these accounts to ensure proper presentation of merchandise and point-of-purchase marketing materials. Sales executives and merchandising personnel work closely with accounts to ensure the appropriate styles are purchased for specific accounts and for specific stores within those accounts. Management believes these close relationships help the Company to maximize their customers' (i) retail sell-through, (ii) maintained margins and (iii) inventory turns. Management believes that limiting product distribution to the appropriate accounts and closely working with those accounts helps the Company to reduce its own inventory markdowns and customer returns and allowances while maintaining the proper showcase for the Skechers brand name and product.

**Leverage Management Expertise and Infrastructure.** The Company's management and design team collectively possess extensive experience in the footwear industry. Robert and Michael Greenberg, the Chairman of the Board and President, respectively, founded the Company in 1992. Robert Greenberg co-founded L.A. Gear and, together with a management team which included Michael Greenberg, was instrumental in L.A. Gear's growth until his resignation in early 1992. The Greenbergs are joined on the management team by several design, merchandise, production and marketing executives with experience at a broad range of industry participants, including: Robinson's-May, Macy's, Kinney Shoe Corporation, Foot Locker, Pentland, Stride-Rite, and Track 'n Trail, as well as L.A. Gear. Management believes this core group comprises an effective and efficient management and design team with the experience to recognize and respond to emerging consumer trends and demands.

As the Company's net sales growth has accelerated, management has focused on investing in infrastructure to support continued expansion in a disciplined manner. Major areas of investment have included the expansion of the Company's distribution facilities, hiring of additional personnel, development of product sourcing and a quality control office in Taiwan, upgrading the Company's management information systems and development and expansion of Company's retail stores. The Company has established this infrastructure to achieve further economies of scale in anticipation of continued increases in net sales.

## GROWTH STRATEGIES

The Company's growth strategies are to (i) expand product offerings, (ii) increase penetration of existing domestic accounts, (iii) open new retail stores and pursue other direct sales channels, (iv) expand international operations and (v) selectively license the Skechers brand name.

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**Expand Product Offerings.** The Company continually seeks to develop new styles in existing categories and enter new product categories in an effort to



grow net sales and earnings. In keeping with this strategy, the Company has been working to introduce new styles in its existing men's and women's categories. Such new styles include the men's Jammer in June 1998 and the women's Blaster in November 1997. The Company has also launched several new product categories over the past year including: Skechers Sport, which includes joggers and court shoes; Skechers Collection, a men's line featuring dress casual shoes designed to complement a young man's evening attire; and Skechers Lights, a children's line which features motion- and contact-activated lights in the outsole and other areas of the shoes.

**Increase Penetration of Existing Domestic Accounts.** Management's goal is to continue to increase net sales and earnings by expanding the number of styles carried by its existing accounts, increasing the retail sell-through of existing accounts and opening new locations with existing accounts. Between 1993 and 1997, the number of accounts which carry Skechers' products increased from approximately 50 to approximately 2,022. In addition, the nature of the account base has transitioned in the direction of larger accounts with multiple stores, resulting in substantially higher sales per account. The Company's strategy is to continue to better serve these accounts and grow within the existing account base so that the Company's products will be more fully represented in existing retail locations and new locations within each account. This growth strategy is expected to be augmented as specialty retail accounts continue to open new locations of their own. In addition to increasing its penetration of existing accounts, the Company intends to selectively open new accounts in the future in an effort to enhance the Company's image and increase net sales and earnings.

**Open New Retail Stores and Pursue Other Direct Sales Channels.** While the Company's retail stores accounted for less than 6.0% of net sales for both 1997 and the three months ended March 31, 1998, and are used primarily for strategic purposes, each retail store that was open for a full calendar quarter made a positive contribution to earnings in 1997. The Company plans to increase the number of retail locations in the future to further its strategic goals as well as in an effort to increase net sales and net earnings. The Company plans to open at least four new concept stores and two new outlet stores in the remainder of 1998 and approximately seven new concept stores and 11 new outlet stores in 1999. In addition, the Company intends to launch its first direct sales effort through the introduction of the Skechers mail-order catalog in the third quarter of 1998. The initial mail-order catalog will include 30 styles each of the Company's men's and women's line. The catalog will be supplemented by the Company's Internet website which is currently being redesigned to allow customers to purchase the same 60 styles over the Internet. Management believes that these new distribution channels will not generate material growth for the Company in the near term; however, management believes that they may present attractive long-term opportunities with minimal near-term costs.

**Expand International Opportunities.** Although the Company's primary focus is on the domestic market, the Company presently markets its product in countries in Europe, Asia and selected other foreign regions through distributorship agreements. For the year ended December 31, 1997 and the three months ended March 31, 1998, approximately 15.1% and 13.6% of the Company's net sales were derived from its international operations, respectively. The Company's goal is to increase sales through distributors by heightening the Company's marketing support in these countries. In 1998, the Company launched its first major international advertising campaign in Europe and Asia. This advertising program is designed to establish Skechers as a global brand synonymous with casual shoes. In an effort to increase profit margins on products sold internationally and more effectively promote the Skechers brand name, the Company is exploring selling directly to retailers in certain European countries in the future. In addition, the Company plans to begin selectively opening flagship retail stores internationally on its own or through joint ventures.

**Selectively License the Skechers Brand Name.** Management believes that selective licensing of the Skechers brand name to non-footwear-related manufacturers may broaden and enhance the

Skechers image without requiring significant capital investments or the incurrence of significant incremental operating expenses by the Company. The Company currently has a licensing agreement internationally for apparel with Life Gear in Japan. The Company also licenses the Skechers' brand name for footwear to Pentland in the United Kingdom. The Company's domestic licensing is limited to its license with The Venator Group for the limited purpose of producing and marketing apparel exclusively in its stores. Management intends to

be selective in pursuing licensing business and expects to begin by entering into licenses for accessories and thereafter expanding to apparel. Management believes that revenues from licensing agreements will not be a material source of growth for the Company in the near term; however, management believes that licensing arrangements may present attractive long-term opportunities with minimal near-term costs.

## FOOTWEAR

Skechers offers men's, women's and children's footwear in a broad range of styles, fabrics and colors. The Company offers a broad selection of merchandise in an effort to maximize its ability to respond to changing fashion trends and consumer preferences as well as to limit its exposure to any specific style. For 1997, 59.6%, 27.8% and 11.8% of gross sales at wholesale were derived from men's, women's and children's footwear, respectively. For the three months ended March 31, 1998, 45.2%, 40.9% and 11.8% of gross sales at wholesale were derived from men's, women's and children's footwear, respectively. As of March 31, 1998, the Company offered approximately 600 different styles of footwear. Of these styles, approximately 47.6% were styles management considers basic, while 52.4% were styles management considers seasonal or fashion footwear. Management generally considers styles that have been in the Company's line for three consecutive seasons as basics. No single style accounted for more than 9.0% of gross sales in either 1997 or the three months ended March 31, 1998.

### Men's Footwear

The Company's introduced its first men's footwear line with the Skechers brand name in June 1993. Since that time, the Company has expanded its product offerings and grown its net sales of Skechers men's footwear while substantially increasing the breadth and penetration of its account base. The Company markets approximately 200 styles of men's footwear, generally ranging its size from 6 1/2 to 13 in five major groups: (i) Casuals, (ii) Active Street Footwear, (iii) Utility Boots, (iv) Hikers and (v) Sandalized Footwear.

Casuals. The Company's Casuals footwear group includes three categories: (i) Sport Utility, (ii) Classics and (iii) Skechers Collection. The Sport Utility category includes boots and shoes that have a rugged, less refined design with industrial-inspired fashion features. This category is defined by the heavy-lugged outsole and value-oriented materials employed in the uppers. Uppers are typically constructed of oiled suede and "Crazy Horse" or distressed leathers which enhance the rugged appearance of the boots and oxfords of this category. The Company designs and prices this category to appeal primarily to a younger men's target customer with broad acceptance across age groups. Suggested retail price points range from \$45.00 to \$65.00 for this category.

The Classics category includes comfort oriented design and performance features. Boots and shoes in this category employ softer outsoles which are often constructed of polyvinyl carbon ("PVC"). The more refined design of this footwear employs better grades of leather and linings than those used in the Company's Sport Utility boots and shoes. Uppers are generally constructed of grizzly leather or highly-finished leather that produces a waxy shine. Designs are sportier than the Sport Utility category and feature oxfords, wingtips, monkstraps, demi-boots and boots. Suggested retail price points range from \$70.00 to \$85.00 for this category.

The Skechers Collection category, which was introduced in 1997, features dress casual shoes designed to complement a young man's evening attire. This category features more sophisticated designs influenced, in part, by prevailing trends in Italy and other European countries. As such, this

footwear is more likely than other categories to be sourced from Italy and Portugal. Outsoles project a sleeker profile, while uppers are constructed of glossy, "box" leather and aniline, resulting in a highly polished appearance. Designs include monkstraps, wingtips, oxfords, cap toes and demi-boots and often feature blind-eyelets to enhance the sophisticated nature of the styling. Suggested retail price points range from \$85.00 to \$100.00 for this category.

Active Street Footwear. The Company's Active Street footwear group includes Street Sneakers and Skechers Sport. Skechers Street Sneakers primarily include low-profile skate sneakers, low-profile and mid-cut sport utility sneakers with industrial-inspired styling and court/gym shoe-inspired street shoes. Outsoles

typically are molded rubber or thermo plastic rubber ("TPR") and, in the case of sport utility sneakers, may feature lugged configurations. Uppers are typically constructed of split suede. While these designs are athletic inspired in general, with the exception of certain skate sneakers, they include few, if any, of the typical technical performance features in today's popular athletic shoes. Certain of the Company's skate sneakers are designed with the technical performance features necessary for competitive level skateboarding. This category is designed to appeal to the teenager whose casual shoe of choice is a skate or street sneaker and is intended to be retailed most heavily through specialty casual shoe stores and department stores. Suggested retail price points range from \$40.00 to \$55.00 for this category.

The Skechers Sport category includes joggers, trail runners, sport hikers and cross-trainers inspired multi-functional shoes. The Company distinguishes its Skechers Sport category by its technical performance inspired looks; however, generally the Company does not promote the technical performance features of these shoes. Skechers Sport footwear includes comfort performance not available in the Street Sneaker category. The Skechers Sport designs are light-weight constructions that include cushioned heels, polyurethane mid-soles, phylon and other synthetic outsoles and white leather or synthetic uppers such as durabuck and cordura and ballistic nylon mesh. The Skechers Sport features electric and technically inspired hues more prominently than it does the traditional athletic white. Skechers Sport is most heavily marketed through traditional athletic footwear specialty retailers. Suggested retail price points range from \$55.00 to \$70.00 for this category.

Utility Boots. The Company's Utility boot group consists of a single category of boots that are designed to meet the functional demands of a work boot but are marketed as casual footwear. The outsoles of this category are designed to be durable and wearable with Goodyear welted, hardened rubber outsoles. Uppers are constructed of thicker, better grades of heavily oiled leathers. Utility boots may include steel toes, water-resistant or water-proof construction and/or materials, padded collars and Thermolite insulation. Styles include logger boots and demi-boots, engineer boots, motorcycle boots and six- and eight-eyelet work boots. Suggested retail price points range from \$80.00 to \$100.00 for this category.

Hikers. The Company's Hiker group consists of a single category of boots and demi-boots that include many comfort and technical performance features that distinguish this footwear as Hikers. The Company markets this footwear primarily on the basis of style and comfort rather than on technical performance. However, many of the technical performance features in the Hikers contribute to the level of comfort this footwear provides. Outsoles generally consist of molded and contoured hardened rubber. Many designs may include gusseted tongues to prevent penetration of water and debris, cushioned mid-soles, motion control devices such as heel cups, water-resistant or water-proof construction and materials and heavier, more durable hardware such as metal D-rings instead of eyelets. Uppers are generally constructed of heavily oiled newbuck and full-grain leathers. Suggested retail price points range from \$55.00 to \$100.00 for this category.

Sandalized Footwear. The Company's Sandalized footwear features open-toe and open-side constructions consistent with the Company's offering in the Sport Utility, Classics, Skechers Collection and Skechers Sport categories of footwear. Such footwear includes fisherman's sandals, shower sandals, beach sandals, slides, comfort-oriented land sandals and technically-inspired water

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sport sandals. Sandalized footwear includes both leather and synthetic constructions and may feature suede footbeds with form-fitting mid-soles. The Company typically delivers its Sandalized footwear to retailers from February to August. Suggested retail price points range from \$20.00 to \$60.00 for this category.

#### Women's Footwear

The Company began emphasizing the marketing and product offerings of its women's footwear line in early 1996. The women's product offerings are organized in four major groups: (i) Casuals, (ii) Active Street Footwear, (iii) Utility Boots and (iv) Sandalized Footwear. Skechers women's line differs from the men's product offerings in that it is more seasonal and fashion oriented. The Company builds all of its women's shoes with lasts and molds specifically designed for women, which management believes distinguishes the Company from most athletic

shoe companies and certain unisex casual footwear companies. The women's line includes a broader array of construction for bottoms which include several different heights. The Company markets approximately 210 styles of women's footwear, generally ranging in size from 5 to 11.

Casuals. The Company's Casuals footwear group includes two categories, Sport Utility and Classics. Sport Utility footwear includes many of the same design features as the Sport Utility category for men, but vary more widely in the fabrication and coloration of uppers, as well as the height and construction of the outsoles. Outsoles may feature raised bottoms with varying heel heights and may be constructed of ethyl vinyl acetate ("EVA"). Suggested retail price points range from \$40.00 to \$55.00 for this category.

The Classics category includes comfort-oriented design and performance features much like the men's Classics category. Boots and shoes in this category of women's footwear are offered in a broader array of upper fabrications and colorations than men's Classics. While these shoes and boots do not feature higher heels, outsole constructions may be thicker or higher than the men's Classics category. In addition to oxfords, wingtips, monkstraps, demi-boots and boots similar to those featured in the men's Classics category, the women's Classics category also features Mary Janes. Suggested retail price points range from \$55.00 to \$70.00 for this category.

Active Street Footwear. The Company's Active Street footwear group includes Street Sneakers and Skechers Sport. Women's Street Sneakers differ from the men's Street Sneakers in four significant ways: (i) variations in outsole configuration, (ii) emphasis on combinations of high-tech and synthetic fabrics, (iii) emphasis on canvas and (iv) the absence of a competitive skate shoe product for women. The women's Street Sneakers are offered in four basic outsole configurations: (i) low profile sneakers such as the Street Cleat, (ii) high profile sneakers such as the Womper, (iii) hyper-wedges such as the Blaster and (iv) platform sneakers such as the Fatsoles. The women's line offers a broader array of coloration and fabrication of uppers and typically emphasizes combinations of different fabrications to make a more bold lifestyle statement than the men's Street Sneaker collection.

Within the Street Sneaker category, the women's line places particular emphasis on canvas uppers. These canvas sneakers are available in a broad array of vivid colors; however, white dominates the canvas sneaker style in sales. Management believes the fuller color palette in canvas is necessary to allow retailers to merchandise these styles effectively and to properly convey the Skechers brand image to the consumer. Canvas Street Sneakers carry suggested retail price points of \$30.00 to \$45.00 for this category. Management believes that these affordable price points contribute to the attractiveness of the more colorful Canvas Street Sneakers as impulse purchases. Suggested retail price points for Street Sneakers, other than in canvas, range from \$40.00 to \$60.00 for this category.

The Skechers Sport Category for women differs from the Skechers Sport Category for men primarily in the variety of colors and fabrics comprising the uppers. While some height variation

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occurs in the outsoles, such variation is not as frequent, severe or diverse as in the case of the Street Sneakers. Suggested retail price points range from \$40.00 to \$60.00 for this category.

Utility Boots. The women's Utility Boot group differs from the men's Utility Boot group in three primary ways: (i) outsoles may be raised and may have higher heels, (ii) uppers may be constructed of softer leather such as oiled newbuck and (iii) the Utility Boot category for women includes women's hikers which is not yet significant enough to warrant its own group. Suggested retail price points for this group range from \$40.00 to \$85.00 for this category.

Sandalized Footwear. Women's Sandalized Footwear consists of three categories: (i) Surf and Sand Sandals, (ii) Active Lifestyle Sandals and (iii) Comfort Sandals. Surf and Sand Sandals feature raised outsoles with wedge or platform configurations and are often constructed from EVA. Footbeds emphasize visual design patterns and colorations and may be constructed from synthetics such as Neoprene. Active Lifestyle Sandals are opened-up interpretations of many of the styles offered in the women's Street Sneaker category. Active Lifestyle

Sandals include the four outsole configurations featured on the Street Cleat, Womper, Blaster and Fatsoles. Uppers typically feature synthetic fabrications. Comfort Sandals are opened-up interpretations of the women's Classics category. Uppers are constructed of similar leathers as the Classics Category with contoured, cushioned suede footbeds. Suggested retail price points range from \$26.00 to \$55.00 for this category.

#### Children's Footwear

In early 1996, the Company substantially increased its product offerings and marketing focus on its children's footwear line and today offers approximately 190 styles of Skechers footwear designed for infants, young boys and girls and pre-teens, ranging in sizes from infant size 5 to boys size 6. The children's line features a range of products including boots, shoes and sneakers that reflect the Skechers level of design and quality. The Skechers children's line is comprised primarily of shoes that are designed like their adult counterparts but in "takedown" versions, so that the younger set can wear the same popular styles as their older siblings and schoolmates. This "takedown" strategy maintains the integrity of the product in the premium leathers, hardware and outsoles without the attendant costs involved in designing and developing new products. In addition, the Company also adapts current fashion from the Company's men's and women's lines by modifying designs and choosing colors and materials that are more suitable to the playful image Skechers has established in the children's footwear market. The Company recently launched its Skechers Lights category, which is a new line of lighted footwear combining sequencing patterns and lights in the outsole and other areas of the shoes. Skechers' children's footwear is currently offered at domestic retail prices ranging from \$30.00 to \$69.00 per pair.

#### PRODUCT DESIGN AND DEVELOPMENT

The Company's principal goal in product design is to generate new and exciting footwear with contemporary and progressive styles and comfort enhancing performance features. The Company designs most new styles to be fashionable and marketable to the 12 to 25 year old consumer, while appealing to the broader 5 to 40 year old age consumer, with the goal that the majority of the styles will become basic. The sale of basic products funds the Company's design efforts and allows it to introduce more progressive styles which improve brand recognition and enhance the Company's image as being in the forefront of emerging lifestyle trends. While many of the Company's shoes have performance features, the Company generally does not position its shoes in the marketplace as technical performance shoes.

The footwear design process typically begins about nine months before the start of a season. Skechers offers a spring and fall line and typically introduces new styles in its existing lines every 30 to 60 days to keep current with emerging trends. Skechers' products are designed and developed by the Company's in-house staff. The Company also utilizes outside design firms on an item-specific basis to supplement its design efforts. Separate design teams focus on each of the men's, women's

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and children's categories, reporting to the Company's Vice President, Design, who has over nine years' experience in footwear design. The design process is extremely collaborative; members of the design staff meet weekly with the heads of retail and merchandising, sales and production and sourcing to further refine the Company's products in order to meet the particular needs of the Company's markets.

Management believes that its product success is related in large part to its ability to recognize trends in the footwear markets and to design products which anticipate and accommodate consumers' ever-evolving preferences. The Company strives to analyze, interpret and translate current and emerging lifestyle trends affecting today's youthful culture into progressive footwear styles. Lifestyle trend information is compiled by Skechers' designers through various methods designed to monitor changes in culture and society, including (i) review and analysis of modern music, television, cinema, clothing, alternative sports and other trend-setting media, (ii) travel to domestic and international fashion markets to identify and confirm current trends, (iii) consultation with the Company's retail customers for information on current retail selling trends, (iv) participation in major footwear trade shows to stay abreast of popular brands, fashions and styles and (v) subscription to various

fashion and color information services. In addition, a key component of Skechers' design philosophy is to continually reinterpret both its basic and current successful styles in the Skechers image. In the Company's experience, reinterpreted styles often sell well due to a combination of a level of familiarity with the target customer group and new design features which create renewed interest. The Company closely monitors sales to key retail customers, as well as Skechers' own retail stores, to identify current popular styles which may be subject to reinterpretation.

After the design team arrives at a consensus regarding the fashion themes for the coming season, the group then translates these themes into Skechers products. These interpretations include variations in product color, material structure and decoration, which are arrived at after close consultation with the Company's production department. Prototype blueprints and specifications are created and forwarded to the Company's prototype manufacturers located in Taiwan, which then forward design prototypes back to the Company's domestic design team approximately two to four weeks after initial receipt. New design concepts are often also reviewed by the Company's major retail customers. This customer input not only allows the Company to measure consumer reaction to the Company's latest designs, but also affords the Company an opportunity to foster deeper and more collaborative relationships with these customers. The Company's design team can easily and quickly modify and refine a design based on this development input.

The Company occasionally orders limited production runs which may initially be tested in Skechers' concept stores. By working closely with store personnel, the Company obtains customer feedback that often influences product design and development. Management believes that sales in Skechers' retail stores can help forecast sales in national retail stores. The Company is able to determine within seven to 14 days after initial introduction of a product whether there is substantial demand for the style, thereby aiding the Company in its sourcing decisions. Styles which have substantial consumer appeal are highlighted in upcoming collections or offered as part of the Company's periodic style offerings. The ability to initially test its products allows Skechers to discontinue less popular styles after only a limited production run which affords the Company an indicator of future production and a hedge to fashion risks. Also, the Company monitors five and 10 weeks trailing trends of orders of its retail account base in order to manage future production of styles that are increasing or decreasing in popularity. Generally, the production process takes approximately six months from design concept to commercialization.

## MARKETING

The Company's marketing focus is to maintain and enhance recognition of the Skechers brand name as a casual, active youthful brand that stands for quality, comfort and design innovation. Senior management is directly involved in shaping the Company's image and its advertising and promotional activities. The conception, development and implementation of most aspects of Skechers

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men's, women's and children's marketing efforts are overseen by a six person committee headed by Robert and Michael Greenberg. Towards this end, the Company endeavors to spend approximately 8.0% of net sales in the marketing of Skechers footwear through an integrated effort of advertising, promotions, public relations, trade shows and other marketing efforts, which the Company believes substantially heightens brand awareness.

Advertising. Substantially all of the Company's advertising is conceived and designed by Skechers' in-house staff. By retaining its advertising functions in-house, management believes that the Company is able to maintain a greater degree of control over both the creative process and the integrity of the Skechers brand image, while realizing substantial cost savings compared to using outside agencies.

Management believes that the Company's success to date is due in large part to its advertising strategies and methods. The Company's in-house marketing and advertising team has developed a comprehensive program to promote the Skechers brand name through lifestyle and image advertising. While all advertisements feature the Company's footwear, Skechers' advertising generally seeks to build and increase brand awareness by linking the brand to youthful, contemporary lifestyles and attitudes rather than to market a particular footwear product. The Company has made a conscious effort to avoid the association of the Skechers name with any single category of shoe to provide merchandise flexibility and to

aid the ability to take the brand and product design in the direction of evolving footwear fashions and consumer preferences.

The Company uses a variety of media for its national advertising. Print efforts are represented by one or two page collage features in popular fashion and lifestyle consumer publications that appeal to the Company's target customer group, such as Spin, Details, Seventeen, GQ, Vibe, Rolling Stone, Vogue and many others. The Company utilizes experienced graphic designers and styling teams that work closely with professional fashion photographers to present the Skechers image in a visually stimulating way. Skechers' progressive television advertisements are primarily created in-house and air frequently on top television shows on the major networks and on cable channels including MTV, Nickelodeon, Comedy Central, ESPN and BET. Different advertisements are created for each of the 5 to 9, 10 to 24 and 25 to 35 year old consumer groups. The Company's in-house media buyer strategically selects during which program and in which geographic area certain Skechers commercials will air in order to reach the appropriate target audience. Radio spots often feature national celebrities and are aired during national syndicated radio shows to appeal to a wider audience.

The Company also participates with its retail customers in cooperative advertising programs intended to take the brand awareness created by the national print advertising and channel it to local retailers where consumers can buy the Company's products. This advertising includes local advertising on radio, television and newspaper, as well as Company participation in major catalogs for retailers such as Macy's, Nordstrom, Bloomingdale's and Victoria's Secret. The Company's co-op efforts are intended to maximize advertising resources by having its retailers share in the cost of promoting the Company's brands. Also, the Company believes that co-op advertising encourages the retailer to merchandise the brands properly and sell them aggressively on the sales floor.

Promotions. Skechers' in-house promotions department is responsible for building national brand name recognition. Teaming up with national retailers and radio stations, the promotions department is responsible for cross promotions, which help draw customers to retail store locations. This department also sponsors alternative sporting and entertainment events and coordinates a group of extreme sport athletes such as skateboarders who make promotional appearances, wear the Company's footwear exclusively and help increase overall consumer awareness of the Skechers brand.

Public Relations. The Company's in-house public relations department is responsible for increasing Skechers' media exposure. The department communicates the Skechers image to the public and news media through the active solicitation of fashion editorial space, arranging interviews with key Company personnel and coordinating local publicity and special events

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programs for the Company, including celebrity appearances and fashion shows. With its strategy tied to promoting the newest styles produced by the product development team, Skechers' products are often featured in fashion and pop culture magazines and on a select group of films and popular television shows.

Trade Shows. To showcase the Skechers product to footwear buyers, the Company exhibits at more than 20 trade shows worldwide, including all leading industry shows. The Company prides itself on having innovative and dynamic exhibits on the show floor. Designed by an in-house architect, the Company's state-of-the-art trade show exhibits feature the latest products and provide a stage for Skechers' internally developed music-video-style dance and stage shows featuring progressive music and nightclub lighting.

Other. The Company's in-house display merchandising department supports retailers and distributors by developing point-of-purchase advertising to further promote its products in stores and to leverage the brand recognition at the retail level. This group is supplemented by several part-time employees who act as field service representatives. This department coordinates with the Company's sales department to ensure better sell-through at the retail level. Company representatives communicate with and visit their customers on a regular basis to aid in the proper visual display of Skechers merchandise and to distribute and display such point-of-purchase items as signage, packaging, displays, counter cards, banners and other visual merchandising displays. These materials mirror the look and feel of the national print advertising in order to reinforce brand image at the point-of-purchase. Management believes these

efforts help stimulate impulse sales and repeat purchases.

Certain of the Company's retail accounts feature "in-store shop" formats in which the Company provides fixtures, signage and visual merchandise assistance in a dedicated floor space within the store. The design of the shops utilizes the distinctive Skechers advertising to promote brand recognition and differentiate Skechers' presence in the store from that of its competition. The installation of these shops enables the Company to establish premium locations within the retailers and management believes it aids in increased sell-through and higher maintained margins for the Company's customers.

The Company intends to launch its initial product mail-order catalog, a full-color brochure to be sent to more than 500,000 households, including approximately 350,000 names on the Company's own mailing list, in the third quarter of 1998. The initial mail-order catalog includes 30 styles each of the Company's men's and women's line. The catalog reflects the Skechers image featuring colorful, eye-catching layouts and younger models. The catalog was created and produced in-house by the Company's designers, with the assistance of professional fashion photographers and production artists. The catalog lists a broad assortment of Skechers footwear and affords customers the ability to order products telephonically or via mail. The catalog references a toll-free Skechers number to provide customer assistance, including the location of the Skechers' retail stores and selected other retail locations offering the Company's products.

The Company also promotes its brand image through its website on the World Wide Web to customers who directly access the Internet. This website currently enables the Company to present information on Skechers' history, products and store locations to consumers. The Company is currently re-designing its website to become interactive, affording customers the ability to directly order products on the Internet and to allow the Company to receive and respond directly to customer feedback. The re-designed website will also feature the Skechers initial mail-order catalog, photos, interviews and information on Company-sponsored events and alternative athletes who wear Skechers products. The Company's website and mail-order catalog are intended to enhance the Skechers brand without the associated costs of advertising.

## SALES

The Company seeks to enhance its brand image by controlling the distribution channels for its products based on criteria which include the image of the retailer and its ability to effectively promote and display the Company's products. In addition, management has implemented a strategy of controlling the growth of the distribution channels through which the Company's products will be sold in order to protect the Skechers brand name, properly service customer accounts and better manage the growth of the business. The Company has limited distribution of its products to those retailers it believes can best support the Skechers brand name in the market. In April 1998, the Company made the decision to discontinue opening new accounts for the remainder of 1998. Although management intends to open new customer accounts in the future, it is currently focusing on increasing sales to existing customers.

To accomplish this, the Company has continued to broaden its product line in an effort to reach a larger consumer base and to improve and enhance its customer service. The Company intends to continue to leverage its reputation for quality products and its relationships with retailers through, among other things, the introduction of new styles in its existing and in also categories of footwear. Also, the Company believes it enhances its position with retailers through its in-stock inventory program. This program increases the availability of Skechers' best-selling products, which management believes has contributed to more consistent product flow to its retail customers and an increased ability to respond to reorder demand.

The Company currently has 51 in-house sales and two independent sales representatives. The Company also has 11 in-house customer service employees. The sales force is segregated into men's, women's and children's divisions. The men's and women's division each has a western, midwestern and eastern regional sales manager, while the children's division is headed by a children's national sales manager. Each of these sales managers reports to the Company's Vice President, Sales, who has over 15 years of experience in the footwear industry. Each of the sales staff and independent sales representatives are compensated on



a salary plus commission basis; none of the representatives sell competitive products. Senior management, specifically Michael Greenberg, is actively involved in selling to and maintaining relationships with Skechers' major retail accounts. For the year ended December 31, 1997 and the three months ended March 31, 1998, the top five sales persons accounted for 40.2% and 41.8% of the Company's net sales, respectively. Two of these salespersons generated 12.8% and 11.0% of the Company's net sales for the year ended December 31, 1997 and 16.2% and 10.8% for the three months ended March 31, 1998, respectively.

The Company's primary customers are department stores and specialty retailers. During 1997, Skechers sold to more than 2,022 retail accounts representing in excess of 10,000 storefronts, including Nordstrom, Macy's, Dillard's, Robinson's-May and JC Penney and specialty retailers such as Genesco's Journeys and Jarman chains, The Venator Group's Foot Locker and Lady Foot Locker chains, Pacific Sunwear and Florsheim. During the year ended December 31, 1997 and the three months ended March 31, 1998, the Company's net sales to its five largest customers accounted for approximately 26.1% and 31.7% of total net sales, respectively. For the three months ended March 31, 1998, The Venator Group represented 11.4% of the Company's net sales. Other than the foregoing, no one customer accounted for 10.0% or more of the Company's net sales for either period.

The Company is committed to achieving customer satisfaction and to building a loyal customer base by providing a high level of knowledgeable, attentive and personalized customer service. The Company's sales and field service personnel coordinate with retail customers to determine the inventory level and product mix that should be carried in each store in an effort to help retail sell-through and enhance the customer's product margin. Such information is then used as a basis for developing sales projections and product needs for such customers. In addition, Skechers' sales personnel work closely with their customers in monitoring their inventory levels, which assists the Company with scheduling production. The Company's field service representatives coordinate with

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the sales department to work with the retailer to ensure that the Company's products are appropriately displayed. Further support is provided through the availability of EDI and co-op advertising. See "-- Distribution." Management believes that limiting product distribution to the appropriate accounts and closely working with those accounts helps the Company to reduce its own inventory markdowns and customer returns and allowances, while maintaining the proper showcase for the Skechers brand name and product.

## SOURCING

Skechers products are produced by independent contract manufacturers primarily located in China and to a lesser extent, in Macau, Korea, Mexico, Romania, Italy, Portugal and Taiwan. For the year ended December 31, 1997 and the three months ended March 31, 1998, 91.6% and 89.0%, of the Company's products were manufactured in China, respectively. The Company does not own or operate any manufacturing facilities. Management believes the use of independent manufacturers increases its production flexibility and capacity while at the same time substantially reducing capital expenditures and avoiding the costs of managing a large production work force. While the Company has long standing relationships with many of its manufacturers and believes its relationships to be good, there are no formal arrangements between the Company and any of its manufacturers .

To safeguard product quality and consistency, the Company oversees the key aspects of the production process. Monitoring is performed domestically by the Company's in-house production department and in Asia through a 47-person staff working in China and out of the Company's office in Taiwan. Management believes the Company's Asian presence allows Skechers to negotiate supplier and manufacturer arrangements more effectively and ensure timely delivery of finished footwear. In addition, the Company requires its manufacturers to certify that neither convict, forced, indentured labor (as defined under U.S. law) nor child labor (as defined by the manufacturer's country) was used in the production process, that compensation will be paid according to local law and that the factory is in compliance with local safety regulations.

The Company oversees the key phases of production from initial prototype manufacture through initial production runs to final manufacture. Manufacturers

are selected in large part on the basis of the Company's prior experience with the manufacturer and the amount of available production capacity. The Company attempts to monitor its selection of independent factories to ensure that no one manufacturer is responsible for a disproportionate amount of the Company's merchandise. In addition, the Company seeks to use, whenever possible, manufacturers that have previously produced the Company's footwear, which the Company believes enhances continuity and quality while controlling production costs. The Company generally limits product orders to 30.0% or less of that manufacturer's total production at any one period of time. In addition, the Company sources product for styles that account for a significant percentage of the Company's net sales from at least three different manufacturers. For the year ended December 31, 1997 and the three months ended March 31, 1998, the top five manufacturers of the Company's products accounted for 74.8% and 40.8% of the Company's manufactured products, respectively. Two of such manufacturers accounted for 21.7% and 15.0% of total production for the year ended December 31, 1997 and one of such manufacturers accounted for 15.5% of total production for the three months ended March 31, 1998. Other than the foregoing, no one manufacturer accounted for 10.0% or more of the Company's total production for either period. To date, the Company has not experienced difficulty in obtaining manufacturing services.

Management believes that quality control is an important and effective means of maintaining the quality and reputation of its products. The Company's quality control program is designed to ensure that finished goods not only meet with Company established design specifications, but also that all goods bearing its trademarks meet the Company's standards for quality. Quality control personnel perform an array of inspection procedures at stages of the production process, including examination and testing of (i) prototypes of key products prior to manufacture, (ii) samples and materials prior to production and (iii) final products prior to shipment. The Company employees are on-site

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at each of Skechers' major manufacturers to oversee in person key phases of production. The Company employees and agents also make other unannounced visits to the manufacturing sites to further monitor compliance with Skechers' manufacturing specifications.

Skechers' on-site quality control program is also designed to provide greater flexibility in the design and production process. Since Skechers reviews many new design concepts with major retail customers, it is able to receive direct feedback as to what changes, if any, in the design specification of a particular style should be made prior to initial production runs. This input often can be quickly translated into design modifications which are directed in Asia by the Company's on-site staff. As a result, the Company is more responsive to customer needs.

The Company maintains an in-stock position for selected styles of footwear in order to minimize the time necessary to fill customer orders. In order to maintain an in-stock position, the Company places orders for selected footwear with its manufacturers prior to the time the Company receives customers' orders for such footwear. In order to reduce the risk of overstocking, the Company seeks to assess demand for its products by soliciting input from its customers and monitoring retail sell-through. In addition, the Company analyzes historical and current sales and market data to develop internal product quantity forecasts which helps reduce inventory risks.

#### SKECHERS' RETAIL STORES

The Company's retail stores are an important component of its product marketing and development strategies and provide distinctive environments in which to merchandise and sell the Skechers product line. The Company's own retail operations are overseen by the Company's Vice President, Retail and Merchandising, who has approximately 20 years of experience in retail footwear. The Company's retail stores consist of free-standing and conventional mall concept stores and factory and warehouse outlet stores. For the year ended December 31, 1997 and the three months ended March 31, 1998, approximately 5.3% and 5.8% of net sales were generated by the Company's retail stores, respectively.

#### Concept Stores

The Company's concept stores serve as a showcase for the Company's products and are an integral part of the Company's strategy for building the Skechers

brand. The Company's strategy is to focus on opening concept stores primarily in marquee sites in key urban, high-traffic, visible locations in major metropolitan cities throughout the United States in an effort to enhance national brand recognition. Retail locations are generally chosen to generate maximum marketing value for the Skechers brand name through signage and store front presentation. These locations include concept stores in Manhattan's Times Square and Santa Monica's Third Street Promenade. The Company believes that as a result of its ability to control the visual presentation and product assortment in its concept stores, these stores help build brand awareness and introduce consumers to a broad range of Skechers products. Also, the concept stores provide rapid product feedback. Management believes that product sell-through information derived from the Company's concept stores allows the Company's sales, merchandising and production staff to respond to market changes and new product introductions. Such responses serve to augment sales and limit the Company's inventory markdowns and customer returns and allowances.

Skechers currently operates 14 concept stores, seven of which are located in California, four in New York, two in New Jersey and one in Massachusetts. The concept stores are primarily located in free-standing street locations and major shopping malls. The stores are typically designed to create a distinctive Skechers look and feel and enhance customer association of the Skechers brand with current youthful lifestyle trends and styles. The concept stores feature modern music and lighting and present an open floor design to allow customers to readily view the merchandise on display. The standard Skechers concept store is open seven days a week for an average of eight to 11 hours per

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day, has two or three employees in the store during business hours, and ranges in selling square footage from approximately 1,400 to 4,400.

The Company opened six new concept stores from January 1, 1998 through July 15, 1998 and plans to open approximately five new concept stores in the remainder of 1998 and approximately seven new concept stores in 1999. The Company's new concept store prototype is approximately 2,500 square feet, although in certain selected markets the Company may open larger or smaller stores. In developing its concept store opening plan, the Company has identified top geographic markets in the larger metropolitan areas of the United States. The Company also has identified specific street and mall locations within each market to be considered for new Skechers concept stores and has signed leases for all concept stores to be opened in 1998. In selecting a specific site, the Company evaluates the proposed sites' traffic pattern, co-tenancies, average sales per square foot achieved by neighboring concept stores, lease economics and other factors considered important within the specific location. Each of the Skechers concept stores that was open for a full quarter made a positive contribution to earnings in 1997.

The Company seeks to instill enthusiasm and dedication in its concept store management personnel and sales associates through incentive programs and regular communication with store personnel. Sales associates receive commissions on sales with a guaranteed minimum compensation. Concept store managers receive base compensation plus incentive compensation based on sales.

The Company has well-established concept store operating policies and procedures and utilizes an in-store training regimen for all new store employees. Merchandise presentation instructions and detailed product descriptions also are provided to sales associates to enable them to gain familiarity with Skechers product offerings. The Company offers Skechers' sales associates a discount on Skechers merchandise to encourage enthusiasm for the product and Company loyalty.

#### Factory and Warehouse Outlet Stores

The Company also operates 12 factory and warehouse outlet stores, seven of which are located in California, two in New York and one in each of Arizona, Massachusetts and Nevada. The factory outlet stores are generally located in manufacturers' outlet centers throughout the country. The Company's factory outlet stores have enabled it to increase sales in certain geographic markets where Skechers' products were not previously available and to consumers who favor value-oriented retailers. The outlets provide opportunities for the Company to sell discontinued and excess merchandise, thereby reducing the need to sell such merchandise to discounters at excessively low prices. The Company's free-standing warehouse outlet stores enable it to liquidate other excess

merchandise, discontinued lines and odd sizes. The Company strives to geographically position its factory and warehouse outlet stores to minimize potential conflicts with the Company's retail customers. The standard Skechers factory and warehouse outlet store is open seven days a week for an average of eight to 11 hours per day, has two or three employees in the store during business hours and ranges in selling square footage from approximately 1,800 to 11,000. Inventory in these stores is supplemented by certain first-line styles sold at full retail generally at price points of \$60.00 or lower. Each of the outlet stores that was open for a full quarter made a positive contribution to earnings in 1997. The Company opened six new factory and warehouse outlet stores from January 1, 1998 through July 15, 1998 and plans to open approximately two new factory and outlet stores in the remainder of 1998 and approximately 11 new factory and warehouse outlet stores in 1999.

In addition, the Company's initial mail-order catalog and website will act as sales vehicles. Management believes that these new distribution channels will not generate material growth for the Company in the near term; however, management believes that they may present attractive long-term opportunities with minimal near-term costs.

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## INTERNATIONAL OPERATIONS

Although the Company's primary focus is on the domestic market, the Company presently markets its product in countries and territories in Europe, Asia and selected other foreign regions. Skechers derives revenues and earnings from outside the United States from two principal sources: (i) sales of Skechers footwear directly to foreign distributors who distribute such footwear to department stores and specialty retail stores and (ii) to a lesser extent, royalties from licensees who manufacture and distribute Skechers products outside the United States. For the year ended December 31, 1997 and the three months ended March 31, 1998, approximately 15.1% and 13.6% of the Company's net sales was derived from its international operations, respectively.

Management believes that international distribution of Skechers products may represent a significant opportunity to increase revenue and profits. Although the Company is in the early stages of its international expansion, Skechers products are currently sold in over 120 countries and territories. The Company's goal is to increase international sales through foreign distributors by heightening the Company's international marketing presence in those countries. In 1998, the Company launched its first major international advertising campaign which is designed to establish Skechers as a global brand synonymous with casual shoes. The Company is exploring selling directly to retailers in certain European countries in the near future. In addition, the Company plans to begin opening flagship retail stores internationally on its own or through joint ventures.

## DISTRIBUTION

The Company believes that strong distribution support is a critical factor in the Company's operations. Following manufacture, the Company's products are packaged in shoe boxes bearing bar codes and generally either shipped to the Company's approximately 412,000 square foot leased distribution center located in Ontario, California, or drop-shipped directly from the manufacturer to Skechers' international customers. Upon receipt at the central distribution center, merchandise is inspected and recorded in the Company's management information system and packaged according to customers' orders for delivery. Merchandise is shipped to the customer by whatever means the customer requests, which is usually by common carrier. The central distribution center has multi-access docks, enabling the Company to receive and ship simultaneously and to pack separate trailers for shipments to different customers at the same time. The Company has an EDI system to which some of the Company's larger customers are linked. This system allows these customers to automatically place orders with the Company, thereby eliminating the time involved in transmitting and inputting orders, and includes direct billing and shipping information. Also, the Company has recently entered into a lease for an additional 286,000 square foot distribution facility.

## POTENTIAL LICENSING ARRANGEMENTS

As part of its growth strategy, the Company plans to continue to enter into licensing agreements with respect to certain products on terms and with parties

management believes will provide more effective manufacturing, distribution or marketing of such products than could be achieved in-house. Management believes that selective licensing of the Skechers brand name to non-footwear-related manufacturers may broaden and enhance the Skechers image without requiring significant capital investments or the incurrence of significant incremental operating expenses by the Company. In evaluating a licensing decision, the Company will consider various factors, including the potential profit to be earned and the capital and management resources available to the Company at such time. The Company intends to maintain substantial control over the design, manufacturing specifications, advertising and distribution of any licensed products and to maintain a policy of evaluating any future licensing arrangements to ensure consistent representation of the Skechers image.

The Company currently has licensing agreements internationally for apparel with Life Gear in Japan. The Company also licenses the Skechers brand name for footwear to Pentland in the United

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Kingdom. The Company's domestic licensing is limited to its license with The Venator Group for the limited purpose of producing and marketing apparel exclusively in its stores. Management intends to be selective in pursuing licensing business and expects to begin by entering into licenses for accessories and thereafter expanding to apparel. Management believes that revenues from licensing agreements will not be a material source of growth for the Company in the near term; however, management believes that licensing arrangements may present attractive long-term opportunities with minimal near-term costs.

#### MANAGEMENT INFORMATION SYSTEMS

The Company recognizes the importance of advanced computerization in maintaining and improving its level of service, internal and external communication and overall competitive position. The Company has a computerized management information system that relies upon a Unix-based format with a local area network of terminals at the corporate offices to support management decision making, along with computers at the Company's distribution center and PC-based point-of-sale computers at each of its retail stores. These computers are connected via modem to the local area network at the Company's corporate offices. The Company's system provides, among other things, comprehensive order processing, production, accounting and management information for the marketing, selling, manufacturing, retailing and distribution functions of the Company's business. The Company has developed a sophisticated software program that enables the Company to track, among other things, orders, manufacturing schedules, inventory and sales of Skechers products. The program includes a centralized management information system which provides the various operating departments with integrated financial, sales, inventory and distribution related information.

As evidence of its continuing dedication to advanced computerization, the Company intends to install a new material handling system in its new distribution center. This new system is expected to enhance the Company's ability to monitor inventory levels and distribution activities at such site. The system, which is expected to cost approximately \$10.0 million, is expected to become operational in mid-1999. In addition, the Company is currently updating its EDI system to make it more responsive to customer needs.

#### BACKLOG

The Company generally receives the bulk of the orders for each of the spring and fall seasons a minimum of three months prior to the date the products are shipped to customers. At June 30, 1998, the Company's backlog was \$164.2 million, compared to \$68.5 million at June 30, 1997. To manage inventory risk, the Company estimates its production requirements and engages in certain other inventory management techniques. See "-- Sourcing." For a variety of reasons, including the timing of shipments, product mix of customer orders and the amount of in-season orders, backlog may not be a reliable measure of future sales for any succeeding period.

#### INTELLECTUAL PROPERTY RIGHTS

The Company owns and utilizes a variety of trademarks, including the Skechers trademark. As of June 30, 1998, the Company had approximately 15

registrations and approximately 30 pending applications for its trademarks in the United States. In addition, as of June 30, 1998, the Company had approximately 145 trademark registrations and applications in over 40 countries. The Company also had three design patents issued in the United States and approximately 40 design patents pending as of June 30, 1998. The Company regards its trademarks and other intellectual property as valuable assets and believes that they have significant value in the marketing of its products. The Company vigorously protects its trademarks against infringement, including through the use of cease and desist letters, administrative proceedings and lawsuits.

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The Company relies on trademark, copyright and trade secret protection, patents, non-disclosure agreements and licensing arrangements to establish, protect and enforce intellectual property rights in the design of its products. In particular, the Company believes that its future success will depend in significant part on the Company's ability to maintain and protect the Skechers trademark. Despite the Company's efforts to safeguard and maintain its intellectual property rights, there can be no assurance that the Company will be successful in this regard. There can be no assurance that third parties will not assert intellectual property claims against the Company in the future. Furthermore, there can be no assurance that the Company's trademarks, products and promotional materials or other intellectual property rights do not or will not violate the intellectual property rights of others, that they would be upheld if challenged or that the Company would, in such an event, not be prevented from using its trademarks or other intellectual property rights. Such claims, if proved, could materially and adversely affect the Company's business, financial condition and results of operations. In addition, although any such claims may ultimately prove to be without merit, the necessary management attention to and legal costs associated with litigation or other resolution of future claims concerning trademarks and other intellectual property rights could materially and adversely affect the Company's business, financial condition and results of operations. The Company has in the past sued and been sued by third parties in connection with certain matters regarding its trademarks and products, none of which has materially impaired the Company's ability to utilize its trademarks.

The laws of certain foreign countries do not protect intellectual property rights to the same extent or in the same manner as do the laws of the United States. Although the Company continues to implement protective measures and intends to defend its intellectual property rights vigorously, there can be no assurance that these efforts will be successful or that the costs associated with protecting its rights in certain jurisdictions will not be prohibitive.

From time to time, the Company discovers products in the marketplace that are counterfeit reproductions of the Company's products or that otherwise infringe upon intellectual property rights held by the Company. There can be no assurance that actions taken by the Company to establish and protect its trademarks and other intellectual property rights will be adequate to prevent imitation of its products by others or to prevent others from seeking to block sales of the Company's products as violating trademarks and intellectual property rights. If the Company is unsuccessful in challenging a third party's products on the basis of infringement of its intellectual property rights, continued sales of such product by that or any other third party could adversely impact the Skechers brand, result in the shift of consumer preferences away from the Company and generally have a material adverse effect on the Company's business, financial condition and results of operations.

## COMPETITION

Competition in the footwear industry is intense. Although the Company believes that it does not compete directly with any single company with respect to its entire range of products, the Company's products compete with other branded products within their product category as well as with private label products sold by retailers, including some of the Company's customers. The Company's utility footwear and casual shoes compete with footwear offered by companies such as The Timberland Company, Dr. Martens, Kenneth Cole, Frye Boot and Wolverine World Wide, Inc. The Company's athletic shoes compete with brands of athletic footwear offered by companies such as Nike, Inc., Reebok International Ltd., Fila Ltd. and Converse, Inc. The Company's children's shoes compete with brands of children's footwear offered by companies such as Stride Rite, Inc. In varying degrees, depending on the product category involved, the Company competes on the basis of style, price, quality, comfort and brand name

prestige and recognition, among other considerations. These and other competitors pose challenges to the Company's market share in its major domestic markets and may make it more difficult to establish the Company in Europe, Asia and other international regions. The Company also competes with numerous manufacturers, importers and distributors of footwear for the limited shelf space available for the display of such products to the

consumer. Moreover, the general availability of contract manufacturing capacity allows ease of access by new market entrants. Many of the Company's competitors are larger, have achieved greater recognition for their brand names, have captured greater market share and/or have substantially greater financial, distribution, marketing and other resources than the Company. There can be no assurance that the Company will be able to compete successfully against present or future competitors or that competitive pressures faced by the Company will not have a material adverse effect on the Company's business, financial condition and results of operations.

EMPLOYEES

As of June 30, 1998, the Company employed 673 persons, 457 of which were employed on a full-time basis and 216 of which were employed on a part-time basis. The Company also from time to time employs part-time personnel. None of the Company's employees is subject to a collective bargaining agreement. The Company believes that its relations with its employees are satisfactory.

PROPERTIES

The Company's corporate headquarters and additional administrative offices are located at three premises in Manhattan Beach, California, and consist of an aggregate of approximately 37,700 square feet. The leases on the premises expire in February 2008, February 2002 and June 2003, respectively, and the current aggregate annual rent is approximately \$891,000.

The Company also leases space for its distribution centers and its retail stores. These facilities aggregate approximately 785,168 square feet, with an annual aggregate base rental of approximately \$5.4 million, plus, in some cases, a percentage of the store's gross sales in excess of the base annual rent. The terms of these leases vary as to duration and rent escalation provisions. The Company has also signed leases for retail stores expected to be opened in 1998. In general, the leases expire between April 2000 and March 2009 and provide for rent escalations tied to either increases in the lessor's operating expenses or fluctuations in the consumer price index in the relevant geographical area.

LEGAL PROCEEDINGS

The Company occasionally becomes involved in litigation arising from the normal course of business. Management believes that any liability with respect to pending legal actions, individually or in the aggregate, will not have a material adverse effect on the Company's business, financial condition and results of operations.

MANAGEMENT

DIRECTORS, EXECUTIVE OFFICERS AND KEY EMPLOYEES

The following table sets forth the name, age as of July 15, 1998, and position with the Company of all directors and executive officers and certain key employees of the Company:

<TABLE>

<CAPTION>

NAME	AGE	POSITION
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<S> Directors and Executive Officers:

Robert Greenberg.....	58	Chairman of the Board and Chief Executive Officer
Michael Greenberg.....	35	President and Director
David Weinberg.....	47	Executive Vice President, Chief Financial

Officer and Director

Philip Paccione.....	36	General Counsel and Secretary
Richard Siskind(1)(2).....	52	Nominated Director
Key Employees:		
Marvin Bernstein.....	51	Vice President, International Sales
Martin Brown.....	36	Vice President, Corporate Imaging
Larry Clark.....	42	Vice President, Production and Sourcing
Lynda Cumming.....	38	Vice President, Allocation and Production
Paul Galliher.....	48	Vice President, Distribution
Kathy Garber.....	38	Vice President, Product Development
Jason Greenberg.....	28	Vice President, Visual Imaging
Jeffrey Greenberg.....	30	Vice President, Electronic Media
Scott Greenberg.....	38	Vice President, Visual Merchandising
Anthony Greenfield.....	50	Vice President and Managing Director,
International Division		
Geric Johnson.....	46	Vice President, Direct Marketing
Michelle Kelchak.....	34	Vice President, Design
Mark Nason.....	36	Vice President, Retail and Merchandising
Ralph Vendetti.....	42	Vice President, Sales

</TABLE>

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(1) Member of the Compensation Committee

(2) Member of the Audit Committee

Robert Greenberg has been the Chairman of the Board and Chief Executive Officer of the Company since October 1993. From 1979 to 1992, Mr. Greenberg was the Chairman of the Board and President of L.A. Gear, an athletic and casual footwear and apparel company.

Michael Greenberg has been the President and a director of the Company since its inception in 1992 and from June 1992 to October 1993 he was Chairman of the Board. From 1989 to 1992, Mr. Greenberg was the National Sales Manager of L.A. Gear. Previously, from 1986 to 1989, he was the Regional Sales Manager of L.A. Gear for the West Coast and, from 1984 to 1986, he was an account representative for the West Coast at L.A. Gear.

David Weinberg has been Chief Financial Officer of the Company since October 1993 and Executive Vice President and a director since July 1998. From June 1989 to September 1992, Mr. Weinberg was Vice President, Credit/Collection at L.A. Gear.

Philip Paccione has been General Counsel since May 1998 and Secretary of the Company since July 1998. Before joining the Company and from June 1997, Mr. Paccione was an attorney at Riordan & McKinzie, located in Los Angeles, and from May 1996 to June 1997 he was a sole practitioner. Mr. Paccione also practiced law at Gartner & Young from December 1994 to May 1996 and at Kelly, Drye & Warren from June 1991 to December 1994.

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Richard Siskind will become a director of the Company upon the completion of the Offering. Mr. Siskind has been President, Chief Executive Officer and a director of Stage II Apparel Corp. (AMEX:SA) since May 1998. In 1991, Mr. Siskind founded R. Siskind & Company, a business which purchases brand name men's and women's apparel and accessories and redistributes those items to off-price retailers, and he is the sole shareholder, a director, Chief Executive Officer and President.

Marvin Bernstein has been the Vice President, International Sales of the Company since May 1997 and joined the Company in June 1993 as Vice President of Key Accounts. In December 1996, Mr. Bernstein became Vice President of International Sales and Licensing.

Martin Brown has been the Vice President, Corporate Imaging of the Company since June 1998, and joined the Company in March 1993 as Director of Special Projects. From October 1992 to 1993 Mr. Brown was an independent marketing consultant.

Larry Clark has been the Vice President, Production and Sourcing of the Company since March 1995 and joined the Company in August 1993 as Vice President of Product Development/ Production, International Division. From 1992 to 1993,



Mr. Clark was Vice President, Operations at ALAD Inc., an apparel company, and from 1985 to 1992 he was Vice President of Research and Development at L.A. Gear. Prior to that, Mr. Clark was at Footlocker-Kinney Shoe Corp. for 10 years.

Lynda Cumming has been the Vice President, Allocation and Production of the Company since October 1992. From 1988 to 1992, Ms. Cumming was Vice President, Allocation at L.A. Gear.

Paul Galliher has been the Vice President, Distribution of the Company since May 1994. Prior to that, from August 1989, he was a Director of Distribution at L.A. Gear.

Kathy Garber has been the Vice President, Product Development of the Company since June 1998 and joined the Company in May 1993 as the Children's Product Manager. In September 1993, she became Product Development Manager and in June 1996 she became Director of Product Development. Ms. Garber was also a buyer at Robinson's-May.

Jason Greenberg has been the Vice President, Visual Imaging of the Company since January 1998 and from June 1992 to July 1998 he was a director. From June 1996 to January 1998, Mr. Greenberg was Advertising Director and from June 1994 he held a product development position at the Company.

Jeffrey Greenberg has been Vice President, Electronic Media of the Company since January 1998. From June 1992 to October 1993 Mr. Greenberg was Chief Financial Officer of the Company and from June 1992 to July 1998 he was Chief Operating Officer, Secretary and a director of the Company. From 1990 to 1992, he was involved in operations and marketing at L.A. Gear.

Scott Greenberg has been Vice President, Visual Merchandising of the Company since January 1998. Prior to that, from June 1994, he was in charge of International Marketing at the Company and held a position in marketing at L.A. Gear from 1986 to 1990. From January 1993 to May 1994 Mr. Greenberg owned and operated a restaurant.

Anthony Greenfield has been the Vice President and Managing Director, International Division of the Company since May 1997. From 1995 to 1997, Mr. Greenfield was the Managing Director of Sportsflair Ltd., a subsidiary of the Pentland Group, with whom the Company has an international distribution agreement. While at Sportsflair Ltd., one of Mr. Greenfield's responsibilities included the oversight of the distribution of Skechers shoes in the United Kingdom. Prior to joining Sportsflair Ltd., Mr. Greenfield was the Joint Managing Director of Allied Footwear Corp., Ltd., a footwear import company operating in the United Kingdom.

Geric Johnson has been the Vice President, Direct Marketing of the Company since January 1998. From January 1990 until January 1998, Mr. Johnson held various positions with Frederick's of Hollywood, Inc., a retailer of women's apparel. While at Frederick's of Hollywood he held the

positions of President, Executive Vice President, General Manager and Vice President of Operations, and his responsibilities included running the day-to-day operations of the Mail Order Division.

Michelle Kelchak has been the Vice President, Design of the Company since June 1998. Ms. Kelchak joined the Company in July 1992 as Head Designer, and from January 1995 through May 1998 served as the Company's Design Director. Prior to joining the Company, Ms. Kelchak was a designer of men's, women's and children's footwear at LA Gear.

Mark Nason has been the Vice President, Retail and Merchandising of the Company since January 1998 and joined the Company in December 1993 as Director of Merchandising and Retail Development. From January 1981 through November 1993, Mr. Nason was employed at Track 'n Trail in various capacities, including General Merchandising Manager, Director of Visual Merchandising and Buyer.

Ralph Vendetti has been the Vice President, Sales of the Company since June 1997 and joined the Company in April 1995 as National Sales Manager. Before that, since 1989, Mr. Vendetti was with KEDS, a division of Stride Rite Corp., most recently as National Accounts Manager handling accounts such as Macy's, Jordan Marsh, Kinney, Bloomingdale's, Federated Corp. and Robinson's-May. Mr.

Vendetti was also employed as a buyer for Macy's for 10 years.

As referenced above, a number of the Company's executive officers, directors and key employees were previously employed by L.A. Gear. During the time of their employment and thereafter, L.A. Gear was subject to many of the uncertainties applicable to the footwear industry. From its fiscal 1985 through mid-fiscal 1990, L.A. Gear experienced a period of rapid growth in revenues and earnings and thereafter periods of declining sales and losses. In late 1991, an outside investor group directed several significant changes in L.A. Gear's management and board of directors. In response to the changes, Robert Greenberg and a number of L.A. Gear's other members of management and employees, some of whom are currently employed by the Company, resigned from L.A. Gear in January 1992. Six years later, in January 1998, L.A. Gear filed for reorganization in bankruptcy court.

Upon the completion of the Offering, the Company's Board of Directors will consist of five members; the Company intends to add an additional non-employee director prior to the effective date of the Offering. The Board of Directors is divided into three classes. Class I Directors will serve until the annual meeting of stockholders in 1999 and thereafter for the terms of three years until their successors have been elected and qualified. Class II Directors will serve until the annual meeting of stockholders in 2000 and thereafter for terms of three years until their successors have been elected and qualified. Class III Directors will serve until the annual meeting of stockholders in 2001 and thereafter for terms of three years until their successors have been elected and qualified. Robert Greenberg is a Class I Director; Michael Greenberg and David Weinberg are Class II Directors; and Richard Siskind and another non-employee director will be Class III Directors.

Directors are elected annually to serve until the next annual meeting of stockholders and until their successors are elected and qualified. The Company intends to pay its non-employee directors annual compensation of \$15,000 for their services paid quarterly beginning upon the completion of the Offering. In addition, non-employee directors will receive a fee of \$1,000 for each meeting attended. Non-employee directors attending any committee meeting will receive an additional fee of \$750 for each committee meeting attended, unless the committee meeting is held on the day of a meeting of the Board of Directors, in which case they will receive no additional compensation for the committee meeting. Non-employee directors will also be reimbursed for reasonable costs and expenses incurred for attending any director and committee meetings. Officers of the Company who are directors will not be paid any directors fees. Concurrently with the Offering, the Company will grant options to purchase \_\_\_\_\_ shares of Common Stock under its Stock Option Plan to each of its non-employee directors. See "-- Stock Options." Robert Greenberg is the father of Michael Greenberg; other than the foregoing, no family relationships exist between any of the directors or executive officers of the Company.

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The Company's Board of Directors has established an Audit Committee and a Compensation Committee. The Audit Committee will be comprised of Richard Siskind and another non-employee director and will be filled upon the completion of the Offering and will be responsible for making recommendations concerning the engagement of independent certified public accountants, approving professional services provided by the independent certified public accountants and reviewing the adequacy of the Company's internal accounting controls. The Compensation Committee will be comprised of Messrs. Siskind and another non-employee director, and will be filled upon completion of the Offering and will be responsible for recommending to the Board of Directors all officer salaries, management incentive programs and bonus payments.

#### COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Company did not have a Compensation Committee in 1997. Messrs. Greenberg and Greenberg participated in deliberations concerning compensation of executive officers during 1997. None of the executive officers of the Company has served on the board of directors or on the compensation committee of any other entity which had officers who served or will serve upon the closing of the Offering on the Company's Board of Directors or on the Company's Compensation Committee.

#### EXECUTIVE COMPENSATION

Summary Compensation Table

The following table sets forth information concerning the annual and long-term compensation earned by the Company's Chief Executive Officer and each of the other executive officers whose annual salary and bonus during 1997 exceeded \$100,000 (the "Named Executive Officers").

<TABLE>  
<CAPTION>

NAME AND PRINCIPAL POSITION	ANNUAL COMPENSATION			LONG-TERM COMPENSATION		PAYOUTS\$(3)	COMPENSATION\$(4)
	OTHER ANNUAL SALARY(\$)	BONUS(\$)	LTIP	ALL OTHER COMPENSATION\$(1)(2)			
Robert Greenberg..... Chairman of the Board and Chief Executive Officer	--	1,560,877	14,518	--	26,305(4)		
Michael Greenberg..... President	300,000	--	8,962	205,250	12,696(5)		
David Weinberg..... Executive Vice President and Chief Financial Officer	175,000	--	4,800	136,830	12,626(6)		

(1) No Named Executive Officer held stock options as of December 31, 1997. On January 15, 1998, the Company granted options to purchase shares of Common Stock to David Weinberg at an exercise price of \$ . See "Management -- Stock Options."

(2) Represents the amount of an automobile lease for the benefit of each officer. With respect to Robert Greenberg and David Weinberg, excludes rental payments of \$12,000 and \$18,000, respectively, made by the Company directly to landlords regarding properties used primarily for corporate purposes but which are leased under the individuals' names.

(3) Represents payment of a bonus based on the increase of the Company's net sales from 1996 to 1997 as more fully described in "-- 1996 Incentive Compensation Plan."

(4) Represents health and life insurance payments of \$6,649 and additional life insurance premiums of \$19,656.

(5) Represents health and life insurance payments of \$9,601 and a \$3,095 contribution by the Company under the Company's 401(k) Plan.

(6) Represents health and life insurance payments of \$9,601 and a \$3,025 contribution by the Company under the Company's 401(k) Plan.

Employment Agreements

Each of Messrs. Robert Greenberg, Michael Greenberg and David Weinberg will enter into an employment agreement with the Company, which will be effective as of the closing of the Offering. The employment agreements will each have an initial term expiring on December 31, 2001 and will be subject to automatic one-year extensions following the expiration of the initial term. The Company and each officer are currently negotiating compensation, which will be determined prior to the closing of the Offering.

The employment agreements will entitle the executives to participate in the Company's Stock Option Plan and to receive certain insurance and other employee plans and benefits established by the Company for its executive employees. The employment agreements will not have any change in control provisions or non-competition covenants.

1996 Incentive Compensation Plan

Certain executive officers and key employees of the Company are entitled to a bonus for 1997 and 1998 based on increases, if any, of the Company's net sales volume in such years over 1996 levels (the "1996 Incentive Compensation Plan").

The bonuses range from 0.1% to 0.3% of the increase in net sales volume and the aggregate amount of bonuses based on the increase in net sales is 1.35%. The bonuses for Michael Greenberg and David Weinberg are 0.3% and 0.2% of the increase in net sales volume, respectively, and, for the year ended December 31, 1997, Messrs. Greenberg and Weinberg were paid \$205,250 and \$136,830, respectively. For the year ended December 31, 1997, an aggregate of \$951,060 in bonuses was paid. As of March 31, 1998, the aggregate amount of such bonuses accrued was \$652,000. Ralph Vendetti received a bonus based on 0.1% of the increase of domestic net sales (excluding the Company's retail stores) for 1997 and 1998, and another salesperson received a bonus based on 0.1% of the increase of children's net sales for 1997 and 1998. Such bonuses are recorded as compensation expense by the Company on a quarterly basis based upon the anticipated increase in net sales for 1998 over historical 1996 net sales levels.

## STOCK OPTIONS

### 1998 Stock Option Plan

In January 1998, the Company's Board of Directors and stockholders adopted the 1998 Stock Option, Deferred Stock and Restricted Stock Plan (the "Stock Option Plan"), which provides for the grant of qualified incentive stock options ("ISOs") that meet the requirements of Section 422 of the Code, stock options not so qualified ("NQSOs"), deferred stock and restricted stock awards ("Grants"). The Stock Option Plan is administered by a committee of directors appointed by the Board of Directors (the "Committee"). ISOs may be granted to the officers and key employees of the Company or any of its subsidiaries. The exercise price for any ISO granted under the Stock Option Plan may not be less than 100% (or 110% in the case of ISOs granted to an employee who is deemed to own in excess of 10.0% of the outstanding Common Stock) of the fair market value of the shares of Common Stock at the time the option is granted. The exercise price for any NQSO granted under the Stock Option Plan may not be less than 85.0% of the fair market value of the shares of Common Stock at the time the option is granted. The purpose of the Stock Option Plan is to provide a means of performance-based compensation in order to attract and retain qualified personnel and to provide an incentive to those whose job performance affects the Company.

The Stock Option Plan authorizes the grant of options to purchase, and Grants of, an aggregate of up to \_\_\_\_\_ shares of the Company's Common Stock. The number of shares reserved for issuance under the Stock Option Plan is subject to anti-dilution provisions for stock splits, stock dividends and similar events. If an option granted under the Stock Option Plan expires or terminates, or a Grant is forfeited, the shares subject to any unexercised portion of such option or

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Grant will again become available for the issuance of further options or Grants under the Stock Option Plan.

Under the Stock Option Plan, the Company may make loans available to stock option holders, subject to the Committee's approval, in connection with the exercise of stock options granted under the Stock Option Plan. If shares of Common Stock are pledged as collateral for such indebtedness, such shares may be returned to the Company in satisfaction of such indebtedness. If so returned, such shares shall again be available for issuance in connection with future stock options and Grants under the Stock Option Plan.

Unless previously terminated by the Board of Directors, no options or Grants may be granted under the Stock Option Plan after January 14, 2008.

Options granted under the Stock Option Plan will become exercisable according to the terms of the grant made by the Committee. Grants will be subject to the terms and restrictions of the award made by the Committee. The Committee has discretionary authority to select participants from among eligible persons and to determine at the time an option or Grant is granted and in the case of options, whether it is intended to be an ISO or a NQSO, and when and in what increments shares covered by the option may be purchased. Under current law, ISOs may not be granted to any individual who is not also an officer or employee of the Company or any subsidiary.

The exercise price of any option granted under the Stock Option Plan is

payable in full (i) in cash, (ii) by surrender of shares of the Company's Common Stock already owned by the option holder having a market value equal to the aggregate exercise price of all shares to be purchased including, in the case of the exercise of NQSOs, restricted stock subject to a Grant under the Stock Option Plan, (iii) by cancellation of indebtedness owed by the Company to the optionholder, (iv) by a full recourse promissory note executed by the optionholder or (v) by any combination of the foregoing. The terms of any promissory note may be changed from time to time by the Board of Directors to comply with applicable Internal Revenue Service or Securities and Exchange Commission regulations or other relevant pronouncements.

The Board of Directors may from time to time revise or amend the Stock Option Plan and may suspend or discontinue it at any time. However, no such revision or amendment may impair the rights of any participant under any outstanding option or Grant without such participant's consent or may, without stockholder approval, increase the number of shares subject to the Stock Option Plan or decrease the exercise price of a stock option to less than 100% of fair market value on the date of grant (with the exception of adjustments resulting from changes in capitalization), materially modify the class of participants eligible to receive options or Grants under the Stock Option Plan, materially increase the benefits accruing to participants under the Stock Option Plan or extend the maximum option term under the Stock Option Plan.

In the event of a change of control, as defined in the Stock Option Plan, all stock options, restricted stock and deferred stock will fully vest and any indebtedness incurred in connection with the Stock Option Plan will be forgiven.

Options to acquire \_\_\_\_\_ shares are outstanding at an exercise price per share of \$ \_\_\_\_\_. Of this amount, \_\_\_\_\_ were granted to an executive officer, of which 25.0% will vest on the consummation of the Offering, and the balance will vest over the next three years. In addition, options to purchase \_\_\_\_\_ shares are expected to be granted to certain employees and non-employee directors of the Company on the effective date of the Offering, which options will vest ratably commencing one year from the date of this Prospectus in 20.0% increments for any employees and officers, and in 33.3% increments for non-employee directors. The options expire ten years from the date of grant.

#### 1998 EMPLOYEE STOCK PURCHASE PLAN

The Company's 1998 Employee Stock Purchase Plan (the "1998 Purchase Plan") was adopted by the Board of Directors and the stockholders in July 1998. The 1998 Purchase Plan, which is intended to qualify under Section 423 of the Code, contains consecutive, overlapping, twelve month offering periods. Each offering period includes two six-month purchase periods. The offering periods generally start on the first trading day on or after May 1 and November 1 of each year. The initial offering period will commence on the date of the initial public offering and expire on April 30, 1999. A total of \_\_\_\_\_ shares have been reserved for issuance under the 1998 Purchase Plan.

Employees are eligible to participate if they are customarily employed by the Company or any designated subsidiary for at least 20 hours per week and more than five months in any calendar year. However, any employee who (i) immediately after grant owns stock possessing 5.0% or more of the total combined voting power or value of all classes of the capital stock of the Company or (ii) whose rights to purchase stock under all employee stock purchase plans of the Company accrue at a rate which exceeds \$25,000 worth of stock for each calendar year may not be granted an option to purchase stock under the 1998 Purchase Plan.

The 1998 Purchase Plan permits participants to purchase Common Stock through payroll deductions of up to 10.0% of the participant's "compensation." Compensation is defined as the participant's base straight time gross earnings, including commissions, incentive bonuses and performance bonuses. Amounts deducted and accumulated by the participant are used to purchase shares of Common Stock at the end of each purchase period. The price of stock purchased under the 1998 Purchase Plan is 85.0% of the lower of the fair market value of the Common Stock at the beginning of the offering period or at the end of the purchase period. The maximum number of shares a participant may purchase during a single offering period is determined by dividing \$25,000 by the fair market value of a share of the Company's Common Stock on the first day of the offering period. In the event the fair market value at the end of a purchase period is

less than the fair market value at the beginning of the offering period, the participants will be withdrawn from the current offering period following exercise and automatically re-enrolled in a new offering period. Participants may end their participation at any time during an offering period, and they will be paid their payroll deductions to date. Participation ends automatically upon termination of employment with the Company.

Rights granted under the 1998 Purchase Plan are not transferable by a participant other than by will, the laws of descent and distribution, or as otherwise provided under the 1998 Purchase Plan.

The 1998 Purchase Plan provides that, in the event of a merger of the Company with or into another corporation or a sale of all or substantially all of the Company's assets, each outstanding option may be assumed or substituted for by the successor corporation. If the successor corporation refuses to assume or substitute for the outstanding options, the offering period then in progress will be shortened and a new purchase date will be set so that shares of Common Stock are purchased with the participant's accumulated payroll deductions prior to the effective date of such transaction.

The Board of Directors has the authority to amend or terminate the 1998 Purchase Plan, except that no such action may adversely affect any outstanding rights to purchase stock under the 1998 Purchase Plan. Unless sooner terminated by the Board of Directors, the 1998 Purchase Plan will terminate on June 30, 2008.

#### 401(K) PLAN

The Company has in place a contributory retirement plan (the "401(k) Plan") for all full time employees with at least 12 months of service, which is designed to be tax deferred in accordance with the provisions of Section 401(k) of the Code. The 401(k) Plan provides that each participant may contribute up to 15.0% of his or her salary, and the Company may contribute to the participant's

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plan account at the end of each plan year a percentage of salary contributed by the participant. Under the 401(k) Plan, employees may elect to enroll on January 1 and July 1 of any plan year, provided that they have been employed for at least one year.

Subject to the rules for maintaining the tax status of the 401(k) Plan, an additional Company contribution may be made at the Company's discretion. Company matching contributions are made at the discretion of the Company. The Company's contributions to the 401(k) Plan in 1996 and 1997 were \$53,000 and \$93,000, respectively.

#### LIMITATIONS ON DIRECTORS' LIABILITIES AND INDEMNIFICATION

The Company's Certificate of Incorporation provides that, except to the extent prohibited by the DGCL, its directors shall not be personally liable to the Company or its stockholders for monetary damages for any breach of fiduciary duty as directors of the Company. Under Delaware law, the directors have fiduciary duties to the Company that are not eliminated by this provision of the Certificate of Incorporation and, in appropriate circumstances, equitable remedies such as injunctive or other forms of non-monetary relief will remain available. In addition, each director will continue to be subject to liability under Delaware law for breach of the director's duty of loyalty to the Company for acts or omissions that are found by a court of competent jurisdiction to be not in good faith or involving intentional misconduct, for knowing violations of law, for actions leading to improper personal benefit to the director and for payment of dividends or approval of stock repurchases or redemptions that are prohibited by Delaware law. This provision also does not affect the director's responsibilities under any other laws, such as the federal securities laws or state or federal environmental laws. In addition, the Company intends to maintain liability insurance for its officers and directors.

Section 145 of the DGCL permits the Company to, and the Certificate of Incorporation provides that the Company shall, indemnify each person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he or she is or was, or has agreed to become, a director or officer of the Company, or is or was serving, or has

agreed to serve, at the request of the Company, as a director, officer or trustee of, or in a similar capacity with, another corporation, partnership, joint venture, trust or other enterprise (including any employee benefit plan), or by reason of any action alleged to have been taken or omitted in such capacity, against all expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him or on his behalf in connection with such action, suit or proceeding and any appeal therefrom. Such right of indemnification shall inure to such individuals whether or not the claim asserted is based on matters that antedate the adoption of the Certificate of Incorporation. Such right of indemnification shall continue as to a person who has ceased to be a director or officer and shall inure to the benefit of the heirs and personal representatives of such a person. The indemnification provided by the Certificate of Incorporation shall not be deemed exclusive of any other rights that may be provided now or in the future under any provision currently in effect or hereafter adopted by the Certificate of Incorporation, by any agreement, by vote of stockholders, by resolution of directors, by provision of law or otherwise. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors of the Company pursuant to the foregoing provision, or otherwise, the Company has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. Section 102(b)(7) of the DGCL permits a corporation to eliminate or limit the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the DGCL relating to unlawful dividends, stock purchases or redemptions or (iv) for any transaction from which the director derived an

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improper personal benefit. Section 102(b)(7) of the DGCL is designed, among other things, to encourage qualified individuals to serve as directors of Delaware corporations. The Company believes this provision will assist it in securing the services of qualified directors who are not employees of the Company. This provision has no effect on the availability of equitable remedies, such as injunction or rescission. If equitable remedies are found not to be available to stockholders in any particular case, stockholders may not have any effective remedy against actions taken by directors that constitute negligence or gross negligence.

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#### CERTAIN TRANSACTIONS

At December 31, 1995, the Company had approximately \$12.0 million, and at December 31, 1996 and 1997, and at March 31, 1998, the Company had approximately \$13.3 million outstanding under the unsecured Stockholder Note payable to the Greenberg Family Trust of which Robert Greenberg, Chairman of the Board and Chief Executive Officer, and M. Susan Greenberg, Robert Greenberg's wife, are trustees. Since January 1, 1997 the Stockholder Note bore interest at 8.0% per annum and was due upon demand after January 1, 1996. The Greenberg Family Trust agreed not to call the Stockholder Note prior to January 1, 1999. The Company recorded interest expense of approximately \$944,000, \$1.1 million, \$1.2 million and \$275,000 related to the Stockholder Note during the years ended December 31, 1995, 1996, 1997 and the three months ended March 31, 1998, respectively. In June 1998, the Company issued a \$13.3 million term note under its credit facility with Heller Financial Inc. to repay the Stockholder Note. The term note bears interest at the prime rate (8.5% at June 30, 1998) plus 25 basis points, and is due in full at the earlier of June 1999 or the closing of the Offering. The term note is guaranteed by the Greenberg Family Trust and is collateralized by approximately \$13.3 million in cash pledged by the Greenberg Family Trust to support its guaranty. The Company intends to use a portion of the net proceeds of the Offering to repay the term note which will have the effect of terminating the guaranty.

The Company has periodically advanced to the Greenberg Family Trust all or a portion of the interest payment due on the Stockholder Note. During the years ended December 31, 1995, 1996 and 1997 and the three months ended March 31, 1998, the Company advanced \$89,490, \$220,416, \$301,439 and \$255,802, of such

interest payments, respectively. The Greenberg Family Trust intends to repay all outstanding amounts on or before the closing of the Offering.

During the years ended December 31, 1995, 1996 and 1997, the Company made S Corporation distributions of \$170,000, \$112,000 and \$3.2 million, respectively, of which \$72,342, \$94,660 and \$2.7 million, respectively, was paid to the Greenberg Family Trust, \$65,757, \$11,136 and \$255,392, respectively, was paid to Michael Greenberg, President. In addition, Jason Greenberg, a former director, received \$2,009, zero and \$114,446, respectively, and Jeffrey Greenberg, former Chief Operating Officer and director, received \$3,402, zero and \$130,543, respectively.

As a result of a tax refund from the payment of taxes on the Company's earnings, the Company received a recovery of distributions from stockholders of \$600,000 for the year ended December 31, 1996 and \$305,000 for the three months ended March 31, 1998.

In August 1998, the Company will make the August Tax Distributions consisting of the final installment of income taxes payable on S Corporation earnings for 1997. It is estimated that the August Tax Distribution will be \$3.6 million, all of which will be paid to the Greenberg Family Trust.

The Company intends to use a portion of the net proceeds of the Offering to pay (i) the Final Tax Distribution consisting of income taxes payable on S Corporation earnings from January 1, 1998 through the date of termination of the Company's S Corporation status and (ii) the Final S Corporation Distribution in an amount designed to constitute substantially all of the Company's remaining undistributed accumulated taxable S Corporation earnings through the date of termination of the Company's S Corporation status. It is estimated that the amount of the Final Tax Distribution will be \$7.0 million, of such amount, \$4.6 million and \$700,000 will be paid to the Greenberg Family Trust and Michael Greenberg, respectively. It is estimated that the amount of the Final S Corporation Distribution will be \$15.0 million, of such amount, \$9.8 million and \$1.5 million will be paid to the Greenberg Family Trust and Michael Greenberg, respectively.

In connection with the Offering and the termination of the Company's S Corporation tax status, the Company entered into a tax indemnification agreement with each of its stockholders, including the Greenberg Family Trust and Michael Greenberg. The agreements provide that the Company will indemnify and hold harmless each of the stockholders for Federal, state, local or foreign income tax

liabilities, and costs relating thereto, resulting from any adjustment to the Company's income that is the result of an increase or change in character of the Company's income during the period it was treated as an S Corporation. The agreements also provide that if there is a determination that the Company was not an S Corporation prior to the Offering, the stockholders will pay to the Company certain refunds actually received by them as a result of that determination.

Shares of Common Stock held by the Greenberg Family Trust and Michael Greenberg are subject to certain registration rights. See "Description of Capital Stock -- Registration Rights."

The Company intends to enter into employment agreements with certain executive officers. See "Management -- Executive Compensation -- Employment Agreements."

#### PRINCIPAL STOCKHOLDERS

The following table sets forth certain information regarding the beneficial ownership of the Company's Common Stock by (i) each director and nominated director of the Company, (ii) each of the Named Executive Officers, (iii) each person known to the Company to be beneficial owner of more than 5% of the Common Stock and (iv) all directors and executive officers of the Company as a group.

<TABLE>  
<CAPTION>

SHARES	PERCENT BENEFICIALLY OWNED(2)
BENEFICIALLY	-----



NAME OF BENEFICIAL OWNER(1)(2)	OWNED(2)	BEFORE OFFERING	AFTER OFFERING
<S>	<C>	<C>	<C>
Robert Greenberg(3)(4).....	19,986,200	65.0%	--
Michael Greenberg.....	3,074,800	10.0	--
David Weinberg(5).....	76,870	*	*
Richard Siskind.....	--	--	--
All directors and executive officers as a group (5 persons).....	23,137,870	75.3%	--

</TABLE>

\* Less than 1.0%

(1) To the Company's knowledge, except as set forth in the footnotes to this table and subject to applicable community property laws, each person named in the table has sole voting and investment power with respect to the shares of Common Stock set down opposite such person's name. Each of such persons may be reached at 228 Manhattan Beach Boulevard, Manhattan Beach, California 90266.

(2) The percentage of beneficial ownership is calculated assuming 30,748,000 shares of Common Stock were outstanding on July 15, 1998 and shares will be outstanding immediately following the completion of the Offering. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission (the "Commission") and generally includes voting or investment power with respect to the securities. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of Common Stock subject to options held by that person that are currently exercisable or exercisable within 60 days of July 15, 1998 are deemed outstanding. Such shares, however, are not deemed outstanding for the purposes of computing the percentage ownership of each other person.

(3) Represents 19,986,200 shares which Mr. Greenberg is deemed to beneficially own as a Trustee of the Greenberg Family Trust. M. Susan Greenberg, Robert Greenberg's wife, is also a trustee of the Greenberg Family Trust and is also deemed to beneficially own all shares held by the Greenberg Family Trust.

(4) Does not reflect the sale of the maximum number of shares which may be sold by the Selling Stockholder if the over-allotment option is exercised in full. If such option is exercised in full, the Greenberg Family Trust will sell shares and Robert Greenberg will beneficially own % of the Company's Common Stock at such time.

(5) Represents shares of Common Stock underlying options, which are currently exercisable within 60 days of the date of this Prospectus.

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## DESCRIPTION OF CAPITAL STOCK

The authorized capital stock of the Company consists of 100,000,000 shares of Common Stock and 10,000,000 shares of Preferred Stock. After giving effect to the Offering, there will be shares of Common Stock outstanding and no shares of Preferred Stock outstanding.

### COMMON STOCK

Holders of Common Stock are entitled to one vote per share on matters to be voted upon by the stockholders. There are no cumulative voting rights. Holders of Common Stock are entitled to receive ratable dividends when, as and if declared by the Board of Directors out of funds legally available therefor. Upon the liquidation, dissolution or winding up of the Company, holders of Common Stock share ratably in the assets of the Company available for distribution to its stockholders, subject to the preferential rights of any then-outstanding shares of Preferred Stock. No shares of Preferred Stock will be outstanding immediately following the consummation of the Offering. Holders of Common Stock have no preemptive, subscription, redemption or conversion rights. All shares of Common Stock outstanding upon the effective date of this Prospectus, and the shares offered hereby will, upon issuance and sale, be fully paid and nonassessable.

## PREFERRED STOCK

The Board of Directors has the authority, without further action by the stockholders of the Company, to issue up to 10,000,000 shares of Preferred Stock in one or more series, and to fix the designations, rights, preferences, privileges, qualifications and restrictions thereof including dividend rights, conversion rights, voting rights, rights and terms of redemption, liquidation preferences and sinking fund terms, any or all of which may be greater than the rights of the Common Stock. The Board of Directors, without stockholder approval, can issue Preferred Stock with voting, conversion and other rights which could adversely affect the voting power and other rights of the holders of Common Stock. Preferred Stock could thus be issued quickly with terms calculated to delay or prevent a change in control of the Company or to make removal of management more difficult. In certain circumstances, such issuance could have the effect of decreasing the market price of the Common Stock. The issuance of Preferred Stock may have the effect of delaying, deterring or preventing a change in control of the Company without any further action by the stockholders including, but not limited to, a tender offer to purchase Common Stock at a premium over then current market prices. The Company has no present plan to issue any shares of Preferred Stock.

## REGISTRATION RIGHTS

The Company has entered into a registration rights agreement with the Greenberg Family Trust, of which Robert Greenberg, Chairman of the Board and Chief Executive Officer, is a Trustee, and Michael Greenberg, President, pursuant to which the Company has agreed that it will, on up to two separate occasions per year, register up to one-third of the shares in any one year beneficially owned as of the closing of the Offering by each such stockholder. The Company also agreed that, if it shall cause to be filed with the Commission a registration statement, each such stockholder shall have the right to include up to one-third of the shares beneficially owned as of the closing of the Offering by each of them in such registration statement subject to limitations due to marketing conditions. All expenses of such registrations shall be at the Company's expense. See "Certain Transactions."

## ANTI-TAKEOVER EFFECTS OF PROVISIONS OF THE COMPANY'S CHARTER AND BYLAWS

The Company's Bylaws provide that the Board of Directors is divided into three classes. Class I Directors will serve until the annual meeting of stockholders in 1999 and thereafter for the terms of three years until their successors have been elected and qualified. Class II Directors will serve until the annual meeting of stockholders in 2000 and thereafter for terms of three years until their successors have been elected and qualified. Class III Directors will serve until the annual meeting of

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stockholders in 2001 and thereafter for terms of three years until their successors have been elected and qualified. Stockholders have no cumulative voting rights and the Company's stockholders representing a majority of the shares of Common Stock outstanding are able to elect all of the directors. The Company's Bylaws also provide that any action that is required to be or may be taken at any annual or special meeting of stockholders of the Company, may, if such action has been earlier approved by the Board, be taken without a meeting, without prior notice and without a vote, if a consent in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. The Bylaws provide that only the Company's Board of Directors or the Chairman may call a special meeting of the stockholders.

The classification of the Board of Directors and lack of cumulative voting makes it more difficult for the Company's existing stockholders to replace the Board of Directors as well as for any other party to obtain control of the Company by replacing the Board of Directors. Since the Board of Directors has the power to retain and discharge officers of the Company, these provisions could make it more difficult for existing stockholders or another party to effect a change in management.

These and other provisions may have the effect of deterring hostile takeovers or delaying changes in control or management of the Company. These provisions are intended to enhance the likelihood of continued stability in the

composition of the Board of Directors and in the policies furnished by the Board of Directors and to discourage certain types of transactions that may involve an actual or threatened change of control of the Company. These provisions are designed to reduce the vulnerability of the Company to an unsolicited acquisition proposal. These provisions are also intended to discourage certain tactics that may be used in proxy fights. However, such provisions could have the effect of discouraging others from making tender offers for the Company's shares and, as a consequence, they may also inhibit fluctuations in the market price of the Company's shares that could result from actual or rumored takeover attempts. Such provisions also may have the effect of preventing changes in the management of the Company.

#### SECTION 203 OF THE DELAWARE GENERAL CORPORATION LAW

Generally, Section 203 of the DGCL prohibits a publicly held Delaware corporation from engaging in a broad range of "business combinations" with an "interested stockholder" (defined generally as a person owning 15.0% of more of a corporation's outstanding voting stock) for three years following the date such person became an interested stockholder unless (i) before the person becomes an interested stockholder, the transaction resulting in such person becoming an interested stockholder or the business combination is approved by the board of directors of the corporation, (ii) upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owns at least 85.0% of the outstanding voting stock of the corporation (excluding shares owned by directors who are also officers of the corporation or shares held by employee stock plans that do not provide employees with the right to determine confidentially whether shares held subject to the plan will be tendered in a tender offer or exchange offer), or (iii) on or after such date on which such person became an interested stockholder the business combination is approved by the board of directors and authorized at an annual or special meeting, and not by written consent, by the affirmative vote of at least 66.6% of the outstanding voting stock excluding shares owned by the interested stockholders. The restrictions of Section 203 do not apply, among other reasons, if a corporation, by action of its stockholders, adopts an amendment to its certificate of incorporation or bylaws expressly electing not to be governed by Section 203, provided that, in addition to any other vote required by law, such amendment to the certificate of incorporation or bylaws must be approved by the affirmative vote of a majority of the shares entitled to vote. Moreover, an amendment so adopted is not effective until twelve months after its adoption and does not apply to any business combination between the corporation and any person who became an interested stockholder of such corporation on or prior to such adoption. The Certificate of

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Incorporation and Bylaws do not currently contain any provisions electing not to be governed by Section 203 of the DGCL.

Section 203 of the DGCL may discourage persons from making a tender offer for or acquisitions of substantial amounts of the Common Stock. This could have the effect of inhibiting changes in management and may also prevent temporary fluctuations in the Common Stock that often result from takeover attempts.

#### TRANSFER AGENT AND REGISTRAR

The Transfer Agent and Registrar for the Common Stock is ChaseMellon Shareholder Services.

#### SHARES ELIGIBLE FOR FUTURE SALE

Prior to the Offering, there has been no public market for the Common Stock. No prediction can be made as to the effect, if any, that market sales of shares or the availability of shares for sale will have on the market price prevailing from time to time. Sales of substantial amounts of Common Stock of the Company in the public market could adversely affect prevailing market prices.

After the Offering, the Company will have outstanding        shares of Common Stock. Of the outstanding shares, the        shares to be sold in the Offering will be freely tradeable without restriction or further registration under the Securities Act unless purchased by "affiliates" of the Company as that term is defined in Rule 144 under the Securities Act.

The remaining \_\_\_\_\_ shares of Common Stock outstanding upon completion of the Offering are "restricted securities" as that term is defined in Rule 144, all of which will be eligible for sale under Rule 144 upon completion of the Offering, subject to the lock-up described below. As described below, Rule 144 permits resales of restricted securities subject to certain restrictions.

In general, under Rule 144 as currently in effect, a person (or persons whose shares are aggregated) who beneficially owned shares for at least one year, including any person who may be deemed an "affiliate" of the Company (as the term "affiliate" is defined under the Securities Act), would be entitled to sell within any three month period a number of such shares that does not exceed the greater of 1.0% of the shares of the Company's Common Stock then outstanding ( \_\_\_\_\_ shares immediately after the Offering) or the average weekly trading volume in the Company's Common Stock during the four calendar weeks preceding the date on which notice of the sale is filed with the Commission. A person who is not deemed to have been an "affiliate" of the Company any time during the three months immediately preceding a sale and who has beneficially owned shares for at least two years would be entitled to sell such shares under Rule 144 without regard to the volume limitation described above.

All executive officers, directors, stockholders and optionholders of the Company have agreed that they will not, without the prior written consent of BT Alex. Brown Incorporated on behalf of the Underwriters (which consent may be withheld in its sole discretion) and subject to certain limited exceptions, offer, pledge, sell, contract to sell, sell any option or contract to purchase, sell short, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend or otherwise transfer or dispose of, directly or indirectly, any shares of Common Stock or any securities convertible into or exercisable or exchangeable for Common Stock, or enter into any swap or similar agreement that transfers, in whole or in part, any of the economic consequences of ownership of the Common Stock, for a period commencing on the date of this Prospectus and continuing to a date 180 days after such date; provided, however, that such restrictions do not apply to shares of Common Stock sold or purchased in the Offering or to shares of Common Stock purchased in the open market following the Offering. BT Alex. Brown Incorporated, on behalf of the Underwriters, may, in its sole discretion and at any time without notice, release all or any portion of the securities subject to these lock up agreements. In addition, the Company has agreed that, for a period of 180 days after the date of this Prospectus, it will not, without the consent of BT Alex. Brown Incorporated, make any

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offering, sale, short sale or other disposition of any shares of Common Stock of the Company or other securities convertible into or exchangeable or exercisable for shares of Common Stock or derivative of Common Stock (or agreement for such) except for the grant of options to purchase shares of Common Stock pursuant to the Stock Option Plan and shares of Common Stock issued pursuant to the exercise of options granted under such plan and the grant of purchase rights and issuance of shares under the 1998 Purchase Plan, provided that such options and grants shall not vest, or the Company shall obtain the written consent of the holder thereof not to transfer such shares, until the end of such 180-day period. See "Management -- Stock Options" and "Underwriting."

In general, under Rule 701 under the Securities Act, any employee, director, consultant or advisor of the Company who purchases shares from the Company in connection with a compensatory stock or option plan or other written compensatory agreement is entitled to resell such shares without having to comply with the public information, holding period, volume limitation or notice provisions of Rule 144, and affiliates are eligible to resell such shares 90 days after the effective date of the Offering in reliance on Rule 144, subject to the provisions of the 180-day lock-up arrangements.

The Stock Option Plan authorizes the grant of options to purchase, and awards of, an aggregate of up to \_\_\_\_\_ shares of the Company's Common Stock. Options to purchase \_\_\_\_\_ shares are outstanding. After the expiration of the 180-day lock-up period and subject to certain vesting restrictions, all the shares issued pursuant to the exercise of these stock options may be resold pursuant to Rule 701. In addition, options to purchase \_\_\_\_\_ shares are expected to be granted to certain employees and non-employee directors of the Company on the effective date of the Offering, which options will vest ratably commencing one year from the date of this Prospectus in 20.0% increments for any employees and officers, and in 33.3% increments for non-employee directors. An aggregate of \_\_\_\_\_ shares are reserved for issuance under the 1998 Purchase

Plan. The Company intends to file a Registration Statement on Form S-8 covering the shares that have been reserved for issuance under the Stock Option Plan and the 1998 Purchase Plan, thus permitting the resale of such shares in the public market.

Certain stockholders beneficially owning an aggregate of \_\_\_\_\_ shares of Common Stock have certain registration rights relating to their shares. If such holders, by exercising their registration rights, cause a large number of shares to be registered and sold in the public market, such sales could have a material adverse effect on the market price for the Company's Common Stock. See "Description of Capital Stock -- Registration Rights."

UNDERWRITING

Subject to the terms and conditions of the Underwriting Agreement, the Underwriters named below (the "Underwriters"), through their Representatives, BT Alex. Brown Incorporated and Prudential Securities Incorporated have severally agreed to purchase from the Company the following respective numbers of shares of Common Stock at the initial public offering price less the underwriting discounts and commissions set forth on the cover page of this Prospectus:

<TABLE>  
<CAPTION>

UNDERWRITER	NUMBER OF SHARES
-----	-----
<S>	<C>
BT Alex. Brown Incorporated.....	
Prudential Securities Incorporated.....	
Total.....	=====

</TABLE>

The Underwriting Agreement provides that the obligations of the Underwriters are subject to certain conditions precedent and that the Underwriters will purchase all shares of the Common Stock offered hereby if any of such shares are purchased.

The Company and the Selling Stockholder have been advised by the Representatives of the Underwriters that the Underwriters propose to offer the shares of Common Stock to the public at the initial public offering price set forth on the cover page of this Prospectus and to certain dealers at such price less a concession not in excess of \$ \_\_\_\_\_ per share. The Underwriters may allow, and such dealers may realow, a concession not in excess of \$ \_\_\_\_\_ per share to certain other dealers. After the initial public offering, the offering price and other selling terms may be changed by the Representatives of the Underwriters.

The Selling Stockholder has granted an option to the Underwriters, exercisable not later than 30 days after the date of this Prospectus, to purchase up to \_\_\_\_\_ additional shares of Common Stock at the public offering price less the underwriting discounts and commissions set forth on the cover page of this Prospectus. To the extent that the Underwriters exercise such option, each of the Underwriters will have a firm commitment to purchase approximately the same percentage thereof that the number of shares of Common Stock to be purchased by it shown in the above table bears to \_\_\_\_\_ and the Selling Stockholder will be obligated, pursuant to the option, to sell such shares to the Underwriters. The Underwriters may exercise such option only to cover over-allotments made in connection with the sale of Common Stock offered hereby. If purchased, the Underwriters will offer such additional shares on the same terms as those on which the \_\_\_\_\_ shares are being offered.

The Company and the Selling Stockholder have agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act.

All executive officers, directors, stockholders and optionholders have agreed that they will not, without the prior written consent of BT Alex. Brown Incorporated, on behalf of the Underwriters, (which consent may be withheld in its sole discretion) and subject to certain limited exceptions, offer, pledge, sell, contract to sell, sell any option or contract to purchase, sell short, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend or otherwise transfer or dispose of, directly or indirectly, any

shares of Common Stock or any securities convertible into or exercisable or exchangeable for Common Stock, or enter into any swap or similar agreement that transfers, in whole or in part, any of the economic consequences of ownership of the Common Stock, for a period commencing on the date of this Prospectus and continuing to a date 180 days after such date; provided, however, that such restrictions do not apply to shares of Common Stock sold or purchased in the Offering or to shares of Common Stock purchased in the open market following the Offering. BT Alex. Brown Incorporated, on behalf of the Underwriters, may, in its sole discretion and at any time without notice, release all or any portion of the securities subject to these lock up agreements. In addition, the Company has agreed that, for a period of 180 days after the date

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of this Prospectus, it will not, without the consent of BT Alex. Brown Incorporated, make any offering, sale, short sale or other disposition of any shares of Common Stock of the Company or other securities convertible into or exchangeable or exercisable for shares of Common Stock or derivative of Common Stock (or agreement for such) except for the grant of options to purchase shares of Common Stock pursuant to the Stock Option Plan and shares of Common Stock issued pursuant to the exercise of options granted under such plan and the grant of purchase rights and issuance of shares under the 1998 Purchase Plan, provided that such options and grants shall not vest, or the Company shall obtain the written consent of the holder thereof not to transfer such shares, until the end of such 180-day period. See "Management -- Stock Options" and "Shares Eligible for Future Sale."

The Representatives of the Underwriters have advised the Company and the Selling Stockholder that the Underwriters do not expect to make sales to accounts over which they exercise discretionary authority in excess of 5.0% of the number of shares of Common Stock offered hereby.

Prior to the Offering, there has been no public market for the Common Stock of the Company. Consequently, the initial public offering price for the Company will be determined by negotiations among the Company, the Selling Stockholder and the Representatives. Among the factors to be considered in such negotiations are the history of, and prospects for, the Company and the industry in which it competes, an assessment of the Company management, its past and present operations and financial performance, the prospects for further earnings of the Company, the present state of the Company's development, the general condition of the securities markets at the time of the Offering, the market prices of and demand for publicly traded common stocks of comparable companies in recent periods and other factors deemed relevant.

The Representatives have advised the Company that, pursuant to Regulation M under the Securities Act, certain persons participating in the Offering may engage in transactions, including stabilizing bids, syndicate covering transactions or the imposition of penalty bids, which may have the effect of stabilizing or maintaining the market price of the Common Stock at a level above that which might otherwise prevail in the open market. A "stabilizing bid" is a bid for or the purchase of the Common Stock on behalf of the Underwriters for the purpose of fixing or maintaining the price of the Common Stock. A "syndicate covering transaction" is the bid for or the purchase of the Common Stock on behalf of the Underwriters to reduce a short position incurred by the Underwriters in connection with the Offering. A "penalty bid" is an arrangement permitting the Representatives to reclaim the selling concession otherwise accruing to an Underwriter or syndicate member in connection with the Offering if the Common Stock originally sold by such Underwriter or syndicate member is purchased by the Representative in a syndicate covering transaction and has therefore not been effectively placed by such Underwriter or syndicate member. The Representatives have advised the Company that such transactions may be effected on the New York Stock Exchange or otherwise and, if commenced, may be discontinued at any time.

## LEGAL MATTERS

Certain matters relating to this offering are being passed upon for the Company and the Selling Stockholder by Freshman, Marantz, Orlanski, Cooper & Klein, a law corporation, Beverly Hills, California. Certain legal matters will be passed upon for the Underwriters by Wilson Sonsini Goodrich & Rosati, Professional Corporation, Palo Alto, California.

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## EXPERTS

The financial statements and schedule of Skechers U.S.A., Inc. as of December 31, 1996 and 1997, and for each of the years in the three-year period ended December 31, 1997, have been included herein and in the registration statement in reliance upon the report of KPMG Peat Marwick LLP, independent certified public accountants, appearing elsewhere herein, and upon the authority of said firm as experts in accounting and auditing.

## ADDITIONAL INFORMATION

The Company has filed a Registration Statement under the Securities Act with the Commission with respect to the Common Stock offered hereby. This Prospectus, which constitutes part of the Registration Statement, omits certain of the information contained in the Registration Statement and the exhibits thereto on file with the Commission pursuant to the Securities Act and the rules and regulations of the Commission. Statements contained in this Prospectus such as the contents of any contract or other document referred to are not necessarily complete and in each instance reference is made to the copy of such contract or other document filed as an exhibit to the Registration Statement, each such statement being qualified in all respects by such reference. A copy of the Registration Statement, including the exhibits thereto, may be inspected without charge at the Commission's principal office at 450 Fifth Street, N.W., Judiciary Plaza, Washington, D.C. 20549, and copies of all or any part thereof may be obtained from the Commission upon the payment of certain fees prescribed by the Commission. The Commission also maintains a World Wide Web site that contains reports, proxy and information statements and other information regarding registrants, such as the Company, that file electronically with the Commission. The address of the site is <http://www.sec.gov>.

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## SKECHERS U.S.A., INC.

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&lt;/TABLE&gt;

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## INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders  
Skechers U.S.A., Inc.:

We have audited the accompanying balance sheets of Skechers U.S.A., Inc. as of December 31, 1996 and 1997 and the related statements of operations, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Skechers U.S.A., Inc. as of December 31, 1996 and 1997 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1997 in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP

Los Angeles, California  
March 19, 1998, except  
for the second paragraph of  
note 5 and note 13, which are  
as of July 1, 1998.

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SKECHERS U.S.A., INC.

## BALANCE SHEETS

DECEMBER 31, 1996 AND 1997  
(IN THOUSANDS, EXCEPT SHARE DATA)

## ASSETS

&lt;TABLE&gt;

&lt;CAPTION&gt;

	1996	1997
	-----	-----
<S>	<C>	<C>
Current assets:		
Cash.....	\$ 178	\$ 1,462
Trade accounts receivable, less allowances for bad debts and returns of \$1,120 in 1996 and \$1,990 in 1997.....	19,682	31,231
Due from officers.....	422	355
Other receivables.....	1,010	1,293
	-----	-----
Total receivables.....	21,114	32,879
	-----	-----
Inventories.....	15,811	45,832
Prepaid expenses and other current assets.....	449	739
	-----	-----
Total current assets.....	37,552	80,912
Property and equipment, at cost, less accumulated depreciation and amortization.....	2,321	7,423
Intangible assets, at cost, less applicable amortization....	2,081	1,137
Other assets, at cost.....	197	1,409



-----      -----  
 \$42,151    \$90,881  
 =====    =====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Short-term borrowings.....	\$ --	\$22,837
Current installments of long-term borrowings.....	12,411	300
Accounts payable.....	8,390	36,013
Accrued expenses.....	4,764	4,681
	-----	-----
Total current liabilities.....	25,565	63,831
	-----	-----
Long-term borrowings, excluding current installments.....	--	2,675
Long-term note payable to stockholder.....	13,250	13,250
Commitments, contingencies and subsequent events		
Stockholders' equity:		
Common stock, no par value; authorized 10,000 shares; issued and outstanding 2,000 shares.....		
	2	2
Retained earnings.....	3,334	11,123
	-----	-----
Total stockholders' equity.....	3,336	11,125
	-----	-----
	\$42,151	\$90,881
	=====	=====

</TABLE>

See accompanying notes to financial statements.  
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SKECHERS U.S.A., INC.

STATEMENTS OF OPERATIONS

THREE-YEAR PERIOD ENDED DECEMBER 31, 1997  
(IN THOUSANDS, EXCEPT SHARE DATA)

<TABLE>  
<CAPTION>

	1995	1996	1997
	-----	-----	-----
<S>	<C>	<C>	<C>
Net sales.....	\$110,649	\$115,410	\$ 183,827
Cost of sales.....	78,692	81,199	115,104
	-----	-----	-----
Gross profit.....	31,957	34,211	68,723
Royalty income, net.....	1,843	1,592	894
	-----	-----	-----
	33,800	35,803	69,617
	-----	-----	-----
Operating expenses:			
Selling.....	12,150	11,739	21,584
General and administrative.....	19,850	18,939	32,397
	-----	-----	-----
	32,000	30,678	53,981
	-----	-----	-----
Earnings from operations.....	1,800	5,125	15,636
	-----	-----	-----
Other income (expense):			
Interest.....	(3,676)	(3,231)	(4,186)
Other, net.....	214	61	(37)
	-----	-----	-----
	(3,462)	(3,170)	(4,223)
	-----	-----	-----
Earnings (loss) before income taxes and extraordinary credit.....	(1,662)	1,955	11,413
State income taxes -- all current.....	3	45	390
	-----	-----	-----
Earnings (loss) before extraordinary credit.....	(1,665)	1,910	11,023
Extraordinary credit -- net of state income taxes of \$7.....	443	--	--
	-----	-----	-----
Net earnings (loss).....	\$ (1,222)	\$ 1,910	\$ 11,023
	=====	=====	=====

Pro forma statement of operations data (unaudited):

Earnings (loss) before income taxes (benefit) and extraordinary credit.....	\$ (1,662)	\$ 1,955	\$ 11,413
Income taxes (benefit).....	(665)	782	4,565
	-----	-----	-----
Earnings (loss) before extraordinary credit.....	(997)	1,173	6,848
Extraordinary credit, net of income taxes of \$180.....	270	--	--
	-----	-----	-----
Net earnings (loss).....	\$ (727)	\$ 1,173	\$ 6,848
	=====	=====	=====

Net earnings per share:

Basic.....	
Diluted.....	

Weighted average shares:

Basic.....	
Diluted.....	

</TABLE>

See accompanying notes to financial statements.

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SKECHERS U.S.A., INC.

STATEMENTS OF STOCKHOLDERS' EQUITY

THREE-YEAR PERIOD ENDED DECEMBER 31, 1997

(IN THOUSANDS, EXCEPT SHARE DATA)

<TABLE>

<CAPTION>

	COMMON STOCK			TOTAL	
	SHARES	AMOUNT	RETAINED EARNINGS	STOCKHOLDERS' EQUITY	
	-----	-----	-----	-----	-----
Balance at December 31, 1994.....	<C> 2,000	<C> \$ 2	<C> \$ 2,328	<C> \$ 2,330	
Net loss.....	--	--	(1,222)	(1,222)	
Distributions.....	--	--	(170)	(170)	
	----	----	-----	-----	
Balance at December 31, 1995.....	2,000	2	936	938	
Net earnings.....	--	--	1,910	1,910	
Recovery of distributions from stockholders.....	--	--	600	600	
Distributions.....	--	--	(112)	(112)	
	----	----	-----	-----	
Balance at December 31, 1996.....	2,000	2	3,334	3,336	
Net earnings.....	--	--	11,023	11,023	
Distributions.....	--	--	(3,234)	(3,234)	
	----	----	-----	-----	
Balance at December 31, 1997.....	2,000	\$ 2	\$ 11,123	\$ 11,125	
	=====	=====	=====	=====	

</TABLE>

See accompanying notes to financial statements.

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SKECHERS U.S.A., INC.

STATEMENTS OF CASH FLOWS

THREE-YEAR PERIOD ENDED DECEMBER 31, 1997

(IN THOUSANDS)

<TABLE>

<CAPTION>

	1995	1996	1997
	-----	-----	-----
Cash flows from operating activities:			
Net earnings (loss).....	<C> \$(1,222)	<C> \$ 1,910	<C> \$ 11,023
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities:			

Depreciation and amortization of property and equipment.....	558	743	1,137
Amortization of intangible assets.....	222	289	1,456
Provision (recovery) for bad debts and returns.....	708	(52)	870
(Increase) decrease in:			
Receivables.....	(424)	(2,707)	(12,635)
Inventories.....	(2,902)	7,749	(30,021)
Prepaid expenses and other current assets.....	(304)	418	(290)
Other assets.....	(150)	71	(1,212)
Increase (decrease) in:			
Accounts payable.....	1,566	(4,344)	27,623
Accrued expenses.....	577	2,524	(83)
	-----	-----	-----
Net cash provided by (used in) operating activities.....	(1,371)	6,601	(2,132)
	-----	-----	-----
Cash flows from investing activities:			
Capital expenditures.....	(1,470)	(630)	(6,239)
Intangible assets.....	(349)	(199)	(512)
	-----	-----	-----
Net cash used in investing activities.....	(1,819)	(829)	(6,751)
	-----	-----	-----
Cash flows from financing activities:			
Net proceeds (payments) related to credit line.....	1,567	(7,337)	10,426
Proceeds from long-term debt.....	--	--	3,000
Distributions to stockholders.....	(170)	(112)	(3,234)
Net proceeds from note payable to stockholder.....	2,000	1,250	--
Recovery of distributions from stockholders.....	--	600	--
Other.....	(193)	(41)	(25)
	-----	-----	-----
Net cash provided by (used in) financing activities.....	3,204	(5,640)	10,167
	-----	-----	-----
Net increase in cash.....	14	132	1,284
Cash at beginning of year.....	32	46	178
	-----	-----	-----
Cash at end of year.....	\$ 46	\$ 178	\$ 1,462
	=====	=====	=====
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest.....	\$ 3,686	\$ 3,188	\$ 4,186
Income taxes.....	10	30	226
	=====	=====	=====

</TABLE>

See accompanying notes to financial statements.

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SKECHERS U.S.A., INC.

NOTES TO FINANCIAL STATEMENTS

THREE-YEAR PERIOD ENDED DECEMBER 31, 1997

#### (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### The Company

Skechers U.S.A., Inc. (the "Company") designs, develops, markets and distributes footwear. The Company also operates retail stores.

##### Revenue Recognition

Revenue is recognized upon shipment of product or at point of sale for retail operations. Allowances for estimated returns and discounts are provided when the related revenue is recorded.

Revenues from royalty agreements are recognized as earned.

##### Inventories

Inventories, principally finished goods, are stated at the lower of cost (based on the first-in, first-out method) or market.

## Income Taxes

The Company has elected to be treated for Federal and state income tax purposes as an S Corporation under Subchapter S of the Internal Revenue Code and comparable state laws. As a result, the earnings of the Company have been included in the taxable income of the Company's stockholders for Federal and state income tax purposes, and the Company has generally not been subject to income tax on such earnings, other than California and other state franchise taxes.

The Company accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Due to the S Corporation election, deferred income taxes have been immaterial.

## Depreciation and Amortization

Depreciation and amortization of property and equipment is computed using the straight-line method utilizing the following estimated useful lives:

<TABLE>

<S>	<C>
Furniture, fixtures and equipment	5 years
Leasehold improvements	Useful life or remaining lease term, whichever is shorter

</TABLE>

Intangible assets consist of trademarks and are amortized on a straight-line basis over ten years. The accumulated amortization as of December 31, 1996 and 1997 is \$646,000 and \$940,000, respectively.

## Long-Lived Assets

The Company accounts for long-lived assets, including intangibles, at amortized cost. As part of an ongoing review of the valuation and amortization of long-lived assets, management assesses the carrying value of assets if facts and circumstances suggest that such assets may be impaired. If this review indicates that the assets will not be recoverable, as determined by a nondiscounted cash flow

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SKECHERS U.S.A., INC.

## NOTES TO FINANCIAL STATEMENTS (CONTINUED)

### THREE-YEAR PERIOD ENDED DECEMBER 31, 1997

analysis over the remaining amortization period, the carrying value of the assets would be reduced to its estimated fair market value, based on discounted cash flows.

## Advertising Costs

Advertising costs are expensed as incurred. Advertising expense for the years ended December 31, 1995, 1996 and 1997 approximated \$4.4 million, \$5.2 million and \$11.7 million, respectively.

## Start-Up Costs

Start-up costs are charged to operations as incurred.

## Earnings per Share

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128 ("SFAS No. 128"), "Earnings Per Share." SFAS No. 128 replaced the calculation of primary and diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share is very similar

to the previously reported fully diluted earnings per share. The weighted average diluted shares outstanding gives effect to the sale by the Company of those shares of Common Stock (            shares) necessary to fund the payment of the excess of (i) the sum of stockholder distributions during the previous 12-month period and distributions paid or declared thereafter until the consummation of the Offering in excess of (ii) the S Corporation earnings in the previous 12-month period based on the assumed initial public offering price of \$    per share (the mid-point of the range), net of underwriting discounts and estimated Offering expenses.

#### Stock Compensation

The Company has adopted Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), and has elected to measure compensation cost under Accounting Principles Board Opinion No. 25 and comply with the pro forma disclosure requirements.

#### Use of Estimates

Management has made a number of estimates and assumptions relating to the reporting of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

#### Product Design and Development Costs

The Company charges all product design and development costs to expense when incurred. Product design and development costs aggregated approximately \$848,000, \$1.9 million and \$3.7 million during the years ended December 31, 1995, 1996 and 1997, respectively.

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SKECHERS U.S.A., INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

THREE-YEAR PERIOD ENDED DECEMBER 31, 1997

#### (2) PROPERTY AND EQUIPMENT

Property and equipment is summarized as follows (in thousands):

<TABLE>

<CAPTION>

	1996	1997
	-----	-----
<S>	<C>	<C>
Furniture, fixtures and equipment.....	\$ 2,869	\$ 7,355
Leasehold improvements.....	1,024	2,777
	-----	-----
Total property and equipment.....	3,893	10,132
Less accumulated depreciation and amortization.....	1,572	2,709
	-----	-----
Property and equipment, net.....	\$ 2,321	\$ 7,423
	=====	=====

</TABLE>

#### (3) BANK BORROWINGS

The Company has available a secured line of credit with a financial institution permitting borrowings up to \$70.0 million based upon eligible accounts receivable and inventories. The borrowings bear interest at the rate of prime (8.5% at December 31, 1997) plus 0.75% and the line of credit expires on December 31, 2002. The agreement provides for the issuance of letters of credit up to a maximum of \$18.0 million, which decreases the amount available for borrowings under the agreement. The outstanding letters of credit at December 31, 1997 are \$5.9 million. The Company paid a 1.0% per annum fee on the maximum letter of credit amount plus 0.50% of the difference between the revolving loan commitment less the maximum letter of credit amount. At December 31, 1997, the Company had available credit aggregating approximately \$27.4 million. The agreement contains certain restrictive covenants, including tangible net worth

and net working capital, as defined, with which the Company was in compliance at December 31, 1997.

At December 31, 1997, the Company had \$3.0 million outstanding under a secured note payable with a financial institution, bearing interest at the rate of prime plus 1.0% payable in monthly installments of \$25,000 and due November 30, 2002.

#### (4) NOTE PAYABLE TO STOCKHOLDER

At December 31, 1996 and 1997, the Company had \$13.3 million outstanding under an unsecured note payable to a stockholder, bearing interest at 8.0% and due upon demand after January 1, 1996. The note holder has agreed not to call this note prior to January 1, 1999. Accordingly, the note has been shown as a long-term liability in the accompanying financial statements. The Company recorded interest expense of approximately \$944,000, \$1.2 million and \$1.1 million related to this note during the years ended December 31, 1995, 1996 and 1997, respectively.

#### (5) STOCKHOLDERS' EQUITY

In January 1998, the Board of Directors of the Company adopted the 1998 Stock Option, Deferred Stock and Restricted Stock Plan ("Stock Option Plan"), which provides for the grant of qualified incentive stock options ("ISO"), stock options not qualified and deferred stock and restricted stock. The exercise price for any option granted may not be less than fair value (110% of fair value for ISOs granted to certain employees). Under the Stock Option Plan, 375 shares are reserved for issuance. In January 1998, 100 options were granted at an exercise price of \$38,680 per share. The options vest at the end of seven years from the date of grant. If an initial public offering of the Company's securities is consummated, 25.0% of the outstanding options will

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SKECHERS U.S.A., INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

#### THREE-YEAR PERIOD ENDED DECEMBER 31, 1997

immediately vest and the balance will vest over the next three years. The options expire ten years from the date of grant.

Effective July 1, 1998, the Company adopted the 1998 Employee Stock Purchase Plan ("1998 Stock Purchase Plan"). The 1998 Stock Purchase Plan is intended to qualify as an Employee Stock Purchase Plan under Section 423 of the Internal Revenue Service Code. Under terms of the 1998 Stock Purchase Plan, 200 shares of common stock are reserved for issuance. No shares were issued under the 1998 Stock Purchase Plan.

#### (6) INCOME TAXES

The pro forma unaudited income tax adjustments presented represent taxes which would have been reported had the Company been subject to Federal and state income taxes as a C Corporation, assuming a 40.0% rate. The historical and pro forma provisions for income tax expense were as follows (in thousands):

<TABLE>

<CAPTION>

	1995	1996	1997
	----	----	-----
<S>	<C>	<C>	<C>
Historical income taxes.....	\$ 10	\$ 45	\$ 390
	----	----	-----
Pro forma adjustments (unaudited):			
Federal.....	(376)	610	3,573
State.....	(119)	127	602
	----	----	-----
Total pro forma adjustments.....	(495)	737	4,175
	----	----	-----
Total provision for pro forma income taxes (benefit).....	\$(485)	\$782	\$4,565
	=====	=====	=====

</TABLE>

Pro forma income taxes (benefit) differs from the statutory tax rate of 34.0% as applied to earnings (loss) before income taxes (benefit) as follows:

<TABLE>  
<CAPTION>

	1995	1996	1997
	-----	-----	-----
<S>	<C>	<C>	<C>
Expected income tax expense (benefit).....	\$(412)	\$665	\$3,880
State income taxes, net of Federal benefit.....	(73)	117	685
	-----	-----	-----
	\$(485)	\$782	\$4,565
	=====	=====	=====

</TABLE>

## (7) BUSINESS AND CREDIT CONCENTRATIONS

The Company sells footwear products principally throughout the United States and foreign countries. The footwear industry is impacted by the general economy. Changes in the marketplace may significantly affect management's estimates and the Company's performance. Management performs regular evaluations concerning the ability of its customers to satisfy their obligations and provides for estimated doubtful accounts. Domestic accounts receivable amounted to \$15.3 million and \$29.9 million before allowance for bad debts at December 31, 1996 and 1997, respectively, which generally do not require collateral from customers. Foreign accounts receivable amounted to \$5.5 million and \$3.3 million before allowance for bad debts at December 31, 1996 and 1997, respectively, which generally are collateralized by letters of credit. International net sales amounted to \$22.2 million, \$31.6 million and \$27.7 million for the years ended December 31, 1995, 1996 and 1997, respectively. The Company's credit losses for the years ended December 31, 1995, 1996 and 1997 were \$302,000, \$694,000 and \$908,000, respectively, and did not significantly differ from management's expectations.

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SKECHERS U.S.A., INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

#### THREE-YEAR PERIOD ENDED DECEMBER 31, 1997

For the years ended December 31, 1995, 1996 and 1997, the Company had no customers exceeding 10.0% of net sales. At December 31, 1996, the Company had no customers which exceeded 10.0% of trade receivables. At December 31, 1997, the Company had one customer which represented 14.7% of trade receivables.

The Company's operations are subject to the customary risks of doing business abroad, including, but not limited to, currency fluctuations, custom duties and related fees, various import controls and other monetary barriers, restrictions on the transfer of funds, labor unrest and strikes and, in certain parts of the world, political instability.

## (8) BENEFIT PLAN

The Company has adopted a profit sharing plan covering all employees who are 21 years of age and have completed one year of service. Employees may contribute up to 15.0% of annual compensation. Company contributions to the plan are discretionary and vest over a five-year period. The Company's contributions to the plan amounted to \$53,000 and \$93,000 for the years ended December 31, 1996 and 1997, respectively. In 1995, the Company elected not to contribute to the plan.

## (9) COMMITMENTS AND CONTINGENCIES

### Leases

The Company leases facilities under operating lease agreements expiring through March 2009. The leases are on an all-net basis, whereby the Company pays taxes, maintenance and insurance. The Company also leases certain equipment and automobiles under operating lease agreements expiring at various dates through 1998. Rent expense for the years ended December 31, 1995, 1996 and 1997 approximated \$1.6 million, \$2.5 million and \$3.0 million, respectively.

The Company has entered into a lease for an additional 286,000 square foot distribution facility. The lease commitment related to the new distribution facility has been included in the table below.

Future minimum lease payments under noncancelable operating leases are as follows (in thousands):

<TABLE>

<S>	<C>
Year ending December 31:	
1998.....	\$ 6,311
1999.....	8,013
2000.....	7,563
2001.....	6,853
2002.....	6,471
Thereafter.....	15,654
	-----
	<u>\$50,865</u>

</TABLE>

#### Litigation

The Company is involved in legal claims arising from the ordinary course of business. Management does not believe that the disposition of these matters will have a material effect on the Company's financial position or results of operations.

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SKECHERS U.S.A., INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

THREE-YEAR PERIOD ENDED DECEMBER 31, 1997

#### Purchase Commitments

At December 31, 1997, the Company had purchase commitments of approximately \$41.7 million.

#### (10) OFFERING COSTS

In 1996, the Board of Directors authorized the filing of a registration statement for an initial public offering of the Kani division. Management terminated this offering and charged to operations related offering costs of \$530,000.

#### (11) FAIR VALUE OF FINANCIAL INSTRUMENTS

Cash, trade accounts receivable, other receivables, other current assets, accounts payable and accrued liabilities, short-term borrowings and other liabilities: The carrying amounts approximate fair value because of the short maturity of those instruments.

Long-term borrowings and long-term note payable to stockholder. The carrying value amount approximates fair value because the interest rate charged is consistent with similar facilities with similar underlying security.

#### (12) EXTRAORDINARY CREDIT

In June 1995, Skechers accelerated payment on a promissory note for the purchase of rights to Kani trademarks, in exchange for relief of \$450,000 of a promissory note liability. The Company has recorded this relief of debt as an extraordinary credit, net of \$7,000 of related income taxes.

#### (13) SUBSEQUENT EVENTS

Effective July 1, 1998, the Board of Directors authorized the filing of a registration statement for an initial public offering of the Company's common stock. In connection with the public offering, the Board of Directors intends to approve an amendment to the Company's Certificate of Incorporation increasing the number of shares of common stock authorized to 100,000,000, \$.001 par value.



In addition, the Board of Directors intends to authorize a common stock split. Upon authorization, the amendment and stock split will be reflected retroactively in the Company's financial statements.

In addition, the Company will be reincorporated in Delaware, which will be effected prior to the consummation of the offering whereby the existing California corporation will be merged into a newly formed Delaware corporation and pursuant to which each outstanding share of common stock of the existing California corporation will be exchanged for shares of \$.001 par value common stock of the new Delaware corporation. The Delaware corporation has also authorized 10,000,000 shares of preferred stock, \$.001 par value.

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SKECHERS U.S.A., INC.

BALANCE SHEET

MARCH 31, 1998  
(UNAUDITED)  
(IN THOUSANDS, EXCEPT SHARE DATA)

ASSETS

<TABLE>  
<CAPTION>

	ACTUAL	PRO FORMA
	-----	-----
<S>	<C>	<C>
Current assets:		
Cash.....	\$ 387	\$ 387
Trade accounts receivable, less allowances for bad debts and returns of \$1,982.....	35,232	35,232
Due from officers.....	313	313
Other receivables.....	1,442	1,442
	-----	-----
Total receivables.....	36,987	36,987
	-----	-----
Inventories.....	47,849	47,849
Prepaid expenses and other current assets.....	735	735
	-----	-----
Total current assets.....	85,958	85,958
Property and equipment, at cost, less accumulated depreciation and amortization.....	8,009	8,009
Intangible assets, at cost, less applicable amortization....	1,112	1,112
Deferred tax assets.....	--	1,291
Other assets, at cost.....	1,357	1,357
	-----	-----
	\$96,436	\$97,727
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Short-term borrowings.....	\$47,596	\$47,596
Current installments of long-term borrowings.....	300	300
Accounts payable.....	16,058	16,058
Accrued expenses.....	4,122	4,122
Distributions payable.....	636	13,636
	-----	-----
Total current liabilities.....	68,712	81,712
	-----	-----
Long-term borrowings, excluding current installments.....	2,600	2,600
Note payable to stockholder.....	13,250	13,250
Commitments, contingencies and subsequent events.....		
Stockholders' equity:		
Common stock, no par value; authorized 10,000 shares; issued and outstanding 2,000 shares.....	2	2
Retained earnings.....	11,872	163
	-----	-----
Total stockholders' equity.....	11,874	165
	-----	-----
	\$96,436	\$97,727
	=====	=====

</TABLE>

See accompanying notes to condensed financial statements.  
F-13

SKECHERS U.S.A., INC.

STATEMENTS OF OPERATIONS

THREE-MONTH PERIODS ENDED MARCH 31, 1997 AND 1998  
(UNAUDITED)  
(IN THOUSANDS, EXCEPT SHARE DATA)

<TABLE>  
<CAPTION>

	1997	1998	
	<C>	<C>	
<S>			
Net sales.....	\$27,591	\$ 59,873	
Cost of sales.....	18,384	37,390	
Gross profit.....	9,207	22,483	
Royalty income, net.....	612	132	
	9,819	22,615	
Operating expenses:			
Selling.....	3,715	7,017	
General and administrative.....	6,403	13,093	
	10,118	20,110	
Earnings (loss) from operations.....	(299)	2,505	
Other income (expense):			
Interest.....	(700)	(1,484)	
Other, net.....	68	64	
	(632)	(1,420)	
Earnings (loss) before income taxes (benefit).....	(931)	1,085	
Income taxes (benefit).....	(32)	33	
Net earnings (loss).....	\$ (899)	\$ 1,052	
Pro forma statement of operations data:			
Earnings (loss) before income taxes (benefit).....	\$ (931)	\$ 1,085	
Income taxes (benefit).....	(372)	434	
Net earnings (loss).....	\$ (559)	\$ 651	
Net earnings per share:			
Basic.....			
Diluted.....			
Weighted average shares:			
Basic.....			
Diluted.....			

</TABLE>

See accompanying notes to condensed financial statements.  
F-14

SKECHERS U.S.A., INC.

STATEMENT OF STOCKHOLDERS' EQUITY

THREE-MONTH PERIOD ENDED MARCH 31, 1998  
(UNAUDITED)  
(IN THOUSANDS, EXCEPT SHARE DATA)

<TABLE>

<CAPTION>

	COMMON STOCK		TOTAL	
	SHARES	AMOUNT	RETAINED EARNINGS	STOCKHOLDERS' EQUITY
<S>	<C>	<C>	<C>	<C>
Balance at December 31, 1997.....	2,000	\$2	\$11,123	\$11,125
Net earnings.....	--	--	1,052	1,052
Recovery of distributions from stockholders.....	--	--	305	305
Distributions.....	--	--	(608)	(608)
Balance at March 31, 1998.....	2,000	\$2	\$11,872	\$11,874

</TABLE>

See accompanying notes to condensed financial statements.

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SKECHERS U.S.A., INC.

### STATEMENTS OF CASH FLOWS

THREE-MONTH PERIODS ENDED MARCH 31, 1997 AND 1998  
(UNAUDITED)  
(IN THOUSANDS)

<TABLE>

<CAPTION>

	1997	1998
<S>	<C>	<C>
Cash flows from operating activities:		
Net earnings (loss).....	\$ (899)	\$ 1,052
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment.....	196	583
Amortization of intangible assets.....	69	25
Provision for bad debts and returns.....	1,332	1,982
(Increase) decrease in assets:		
Receivables.....	1,171	(6,090)
Inventories.....	(1,046)	(2,017)
Prepaid expenses and other current assets.....	(10)	4
Other assets.....	(65)	53
Increase (decrease) in liabilities:		
Accounts payable.....	442	(19,955)
Accrued expenses.....	(1,179)	(531)
Net cash provided by (used in) operating activities.....	11	(24,894)
Cash flows used in investing activities:		
Capital expenditures.....	(256)	(1,170)
Intangible assets.....	(71)	--
Net cash used in investing activities.....	(327)	(1,170)
Cash flows from financing activities:		
Net proceeds related to credit line.....	519	24,759
Payments related to long-term debt.....	--	(75)
Distributions to stockholders.....	(356)	--
Recovery of distributions from stockholders.....	--	305
Net cash provided by financing activities.....	163	24,989
Net decrease in cash.....	(153)	(1,075)
Cash at beginning of period.....	178	1,462
Cash at end of period.....	\$ 25	\$ 387

Supplemental disclosures of cash flow information:

Cash paid during the period for:

Interest.....	\$ 505	\$ 840
Income taxes.....	20	260
	=====	=====

</TABLE>

As of March 31, 1998, the Company declared distributions to stockholders amounting to \$608.

See accompanying notes to condensed financial statements.  
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SKECHERS U.S.A., INC.

NOTES TO FINANCIAL STATEMENTS

MARCH 31, 1998  
(UNAUDITED)

(1) GENERAL

The unaudited operating results have been prepared on the same basis as the audited financial statements and, in the opinion of management, include all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation for the periods. The results of operations for interim periods are not necessarily indicative of results to be achieved for full fiscal years.

(2) PRO FORMA INFORMATION

Pro forma balance sheet information as of March 31, 1998 has been presented to reflect the S Corporation distribution ("S Corporation Distribution") to be made to an amount equal to the previously earned and undistributed taxable S Corporation earnings aggregating approximately \$13.0 million through March 31, 1998 as if such distribution had been made at March 31, 1998 and the Company's S Corporation status had been terminated at such date and deferred tax assets of \$1.3 million which would have been recorded had the Company been subject to Federal and state income taxes as a C Corporation.

No adjustment has been made to give effect to the Company's earned and undistributed taxable S Corporation earnings for the period from April 1, 1998 through the S Corporation termination date, which would be distributed as part of the S Corporation Distribution.

The pro forma unaudited income tax adjustments presented represent taxes which would have been reported had the Company been subject to Federal and state income taxes as a C Corporation, assuming a 40.0% rate. The historical and pro forma provisions for income tax expense (benefit) were as follows (in thousands):

<TABLE>  
<CAPTION>

	MARCH 31	
	1997	1998
	----	----
	<C>	<C>
Historical income taxes (benefit).....	\$ (32)	\$ 33
	----	----
Pro forma adjustments (unaudited):		
Federal.....	(288)	336
State.....	(52)	65
	----	----
Total pro forma adjustments.....	(340)	401
	----	----
Total pro forma income taxes (benefit).....	\$(372)	\$434
	=====	=====

</TABLE>

Pro forma income taxes (benefit) differs from the statutory tax rate of 34.0% as applied to earnings before income taxes (benefit) as follows:

<TABLE>  
<CAPTION>

1997 1998

<S>	-----	<C>	<C>
Expected income tax expense (benefit).....		\$(317)	\$369
State income tax, net of Federal benefit (taxes).....		(55)	65
	-----		
Total provision for pro forma income taxes			
(benefit).....		\$(372)	\$434
	=====		=====

</TABLE>

### (3) EARNINGS PER SHARE

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128 ("SFAS No. 128"). "Earnings Per Share." SFAS No. 128 replaced the calculation of primary and diluted earnings per share with basic and diluted earnings per share.

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SKECHERS U.S.A., INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1998  
(UNAUDITED)

Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. Shares outstanding include shares issuable upon exercise of stock options outstanding at March 31, 1998 after applying the treasury stock method based on the assumed initial public offering price of \$ (the mid-point of the range). The weighted average diluted shares outstanding also gives effect to the sale by the Company of those shares of Common Stock ( shares) necessary to fund the payment of the excess of (i) the sum of stockholder distributions during the previous 15-month period and distributions paid or declared thereafter until the consummation of the Offering in excess of (ii) the S Corporation earnings in the previous 15-month period based on the assumed initial public offering price of \$ per share (the mid-point of the range), net of underwriting discounts and estimated Offering expenses.

### (4) RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Effective January 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"). SFAS No. 130 establishes standards to measure all changes in equity that result from transactions and other economic events other than transactions with owners. Comprehensive income is the total of net earnings and all other nonowner changes in equity. Except for net earnings, the Company does not have any transactions and other economic events that qualify as comprehensive income as defined under SFAS No. 130.

In 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131"). SFAS No. 131 introduces a new model for segment reporting called the "management approach." The management approach is based on the manner in which management organizes segments within a company for making operating decisions and assessing performance. The management approach replaces the notion of industry and geographic segments. SFAS No. 131 is effective for the Company as of January 1, 1998; however, in accordance with SFAS No. 131, this statement has not been applied for interim periods in the initial year of application but will be adopted as of December 31, 1998.

The Company believes the adoption of SFAS No. 130 and SFAS No. 131 will not significantly affect the Company's financial position, results of operations or financial statement presentation.

### (5) NOTE PAYABLE TO STOCKHOLDER

At March 31, 1998, the Company had \$13.3 million outstanding under an unsecured note payable to a stockholder, bearing interest at 8.0% and due upon demand after January 1, 1996. The note holder agreed not to call this note prior to January 1, 1999. The Company refinanced this note in June 1998. The Company

recorded interest expense of approximately \$275,000 related to this note during each of the three-month periods ended March 31, 1997 and 1998.

#### (6) BANK BORROWINGS

The Company has available a secured line of credit with a financial institution permitting borrowings up to \$70.0 million based upon eligible accounts receivable and inventories. The borrowings bear interest at the rate of prime (8.5% at March 31, 1998) plus 0.75% and the line of credit expires on December 31, 2002. The agreement provides for the issuance of letters of credit up

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SKECHERS U.S.A., INC.

#### NOTES TO FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1998  
(UNAUDITED)

to a maximum of \$18.0 million, which decreases the amount available for borrowings under the agreement. The outstanding letters of credit at March 31, 1998 are \$2.9 million. The Company paid a 1.0% per annum fee on the maximum letter of credit amount plus 0.50% of the difference between the revolving loan commitment less the maximum letter of credit amount. At March 31, 1998, the Company had available credit aggregating approximately \$22.4 million. The agreement contains certain restrictive covenants, including tangible net worth and net working capital, as defined, with which the Company was in compliance at March 31, 1998.

At March 31, 1998, the Company had \$2.9 million outstanding under a secured note payable with a financial institution, bearing interest at the rate of prime plus 1.0%, payable in monthly installments of \$25,000 and due November 30, 2002.

#### (7) SUBSEQUENT EVENTS

Effective July 1, 1998, the Board of Directors authorized the filing of a registration statement for an initial public offering of the Company's common stock. In connection with the public offering, the Board of Directors intends to approve an amendment to the Company's Certificate of Incorporation increasing the number of shares of common stock authorized to 100,000,000, \$.001 par value. In addition, the Board of Directors intends to authorize a common stock split. Upon authorization, the amendment and stock split will be reflected retroactively in the Company's financial statements.

In addition, the Company will be reincorporated in Delaware, which will be effected prior to the consummation of the offering whereby the existing California corporation will be merged into a newly formed Delaware corporation and pursuant to which each outstanding share of common stock of the existing California corporation will be exchanged for shares of \$.001 par value common stock of the new Delaware corporation. The Delaware corporation has also authorized 10,000,000 shares of preferred stock, \$.001 par value.

In January 1998, the Board of Directors of the Company adopted the 1998 Stock Option, Deferred Stock and Restricted Stock Plan ("Stock Option Plan"), which provides for the grant of qualified incentive stock options ("ISO"), stock options not qualified and deferred stock and restricted stock. The exercise price for any option granted may not be less than fair value (110% fair value for ISOs granted to certain employees). Under the Stock Option Plan, 375 shares are reserved for issuance. In January 1998, 100 options were granted at an exercise price of \$38,680 per share. The options vest at the end of seven years from the date of grant. If an initial public offering of the Company's securities is consummated, 25.0% of the outstanding options will immediately vest and the balance will vest over the next three years. The options expire ten years from the date of grant.

Effective July 1, 1998, the Company adopted the 1998 Employee Stock Purchase Plan (the 1998 Stock Purchase Plan) The 1998 Stock Purchase Plan is intended to qualify as an Employee Stock Purchase Plan under Section 423 of the Internal Revenue Service Code. Under terms of the 1998 Stock Purchase Plan, 200 shares of common stock are reserved for issuance. No shares were issued under the 1998 Stock Purchase Plan.

In May 1998, the Company amended its secured line of credit agreement to allow borrowings up to \$120.0 million from a financial institution based upon eligible accounts receivable and inventories. The borrowings bear interest at the Company's option at the rate of prime 8.5% at June 30, 1998 plus 0.25% or at Libor (5.78% at June 30, 1998) plus 2.75%. The Company elected to designate the Libor rate. The line of credit expires on December 31, 2002. The agreement provides

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SKECHERS U.S.A., INC.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1998  
(UNAUDITED)

for the issuance of letters of credit up to a maximum of \$18.0 million, which decreases the amount available for borrowings under the agreement. The Company is required to maintain certain financial covenants including specified minimum tangible net worth, working capital and leverage ratios and limit the ability of the Company to pay dividends if it is in default of any provisions of the credit facility. The Company was in compliance with these covenants as of March 31, 1998.

In June 1998, the Company refinanced the long-term note payable of \$13.3 million to stockholder. The note was refinanced through a secured note payable with a financial institution, bearing interest at the rate of prime plus 0.25%, due at the earlier of June 1999 or the consummation of an initial public offering of the Company's securities. The note is guaranteed by a stockholder and the guaranty is collateralized by approximately \$13.3 million in cash pledged by the stockholder to support the guaranty.

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NO PERSON HAS BEEN AUTHORIZED IN CONNECTION WITH THE OFFERING MADE HEREBY TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATION NOT CONTAINED IN THIS PROSPECTUS AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE COMPANY, THE SELLING STOCKHOLDER OR ANY UNDERWRITER. THIS PROSPECTUS DOES NOT CONSTITUTE AN OFFER OF ANY SECURITIES OTHER THAN THOSE TO WHICH IT RELATES OR AN OFFER TO SELL, OR A SOLICITATION OF AN OFFER TO BUY, TO ANY PERSON IN ANY JURISDICTION WHERE SUCH OFFER OR SOLICITATION WOULD BE UNLAWFUL. NEITHER THE DELIVERY OF THIS PROSPECTUS NOR ANY SALE MADE HEREUNDER SHALL, UNDER ANY CIRCUMSTANCES, CREATE ANY IMPLICATION THAT THE INFORMATION CONTAINED HEREIN IS CORRECT AS OF ANY TIME SUBSEQUENT TO THE DATE HEREOF.

-----

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Until \_\_\_\_\_, 1998 (25 days after the date of this Prospectus) all dealers effecting transactions in the registered securities, whether or not participating in this distribution, may be required to deliver a Prospectus. This delivery requirement is in addition to the obligation of dealers to deliver a Prospectus when acting as Underwriters and with respect to their unsold allotments or subscriptions.

-----  
 -----  
 -----  
 -----  
 Shares

SKECHERS U.S.A., INC.  
 [LOGO]  
 Common Stock

-----  
 PROSPECTUS  
 -----

BT ALEX. BROWN

PRUDENTIAL SECURITIES INCORPORATED

, 1998  
 -----  
 -----

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 13. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION

The Registrant estimates that expenses in connection with the offering described in this registration statement, other than underwriting discounts and commissions, will be as follows:

<TABLE>

<S>	<C>
Securities and Exchange Commission registration fee.....	\$ 33,942
NASD filing fee.....	12,006
New York Stock Exchange listing fee.....	75,000*
Printing expenses.....	225,000*
Accounting fees and expenses.....	225,000*
Legal fees and expenses.....	300,000*
Directors' and Officers' Insurance.....	1,100,000*
Fees and expenses (including legal fees) for qualifications under state securities laws.....	5,000*
Transfer agent's fees and expenses.....	10,000*
Miscellaneous.....	14,052*
	-----
Total.....	\$2,000,000*
	=====

</TABLE>

-----  
 \* Estimated.

ITEM 14. INDEMNIFICATION OF DIRECTORS AND OFFICERS

Section 145 of the Delaware General Corporation Law permits the Registrant to, and Article VIII of the Registrant's Amended and Restated Certificate of



Incorporation provides that the Registrant shall, indemnify each person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he is or was, or has agreed to become, a director or officer of the Registrant, or is or was servicing, or has agreed to serve, at the request of the Registrant, as a director, officer or trustee of, or in a similar capacity with, another corporation, partnership, joint venture, trust or other enterprise (including any employee benefit plan), or by reason of any action alleged to have been taken or omitted in such capacity, against all expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him or on his behalf in connection with such action, suit or proceeding and any appeal therefrom.

Pursuant to the Underwriting Agreement, the Company and the Selling Stockholder have agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended.

ITEM 15. RECENT SALES OF UNREGISTERED SECURITIES

None.

ITEM 16. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(A) EXHIBITS

<TABLE>	
<CAPTION>	
EXHIBIT	
NUMBER	DESCRIPTION OF EXHIBIT
-----	-----
<C>	<S>
1.1*	Form of Underwriting Agreement
2.1*	Agreement of Reorganization and Plan of Merger
3.1	Certificate of Incorporation

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<TABLE>	
<CAPTION>	
EXHIBIT	
NUMBER	DESCRIPTION OF EXHIBIT
-----	-----
<C>	<S>
3.2	Bylaws
4.1*	Form of Specimen Stock Certificate
5.1*	Opinion of Freshman, Marantz, Orlanski, Cooper & Klein, a law corporation
10.1	Amended and Restated 1998 Stock Option, Deferred Stock and Restricted Stock Plan
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10.4*	Form of Employment Agreement between the Registrant and Michael Greenberg
10.5*	Form of Employment Agreement between the Registrant and David Weinberg
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10.7*	Form of Registration Rights Agreement between the Registrant, the Greenberg Family Trust and Michael Greenberg
10.8*	Tax Indemnification Agreement
10.9*	Promissory Note between the Registrant and Robert Greenberg dated June 12, 1995
10.10*	Amended and Restated Loan and Security Agreement between the Registrant and Heller Financial, Inc., dated _____, 1998
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- 10.15 Lease, dated November 21, 1997, between The Prudential Insurance Company of America, regarding 1777 So. Vintage Avenue, Ontario, California
- 10.16 Commercial Lease, dated April 10, 1998, between the Registrant and Proficiency Ontario Partnership, regarding 5725 East Jurupa Street, Ontario, California
- 23.1 Consent of KPMG Peat Marwick LLP
- 23.2\* Consent of Freshman, Marantz, Orlanski, Cooper & Klein (contained in exhibit 5.1)
- 24.1 Power of attorney (included on signature page of Registration Statement)
- 27 Financial Data Schedules
- 99.1 Consent of Richard Siskind as Nominated Director
- </TABLE>

-----  
\* To be filed by amendment

## (B) SCHEDULES

### Schedule II -- Valuation and Qualifying Accounts

#### ITEM 17. UNDERTAKINGS

(a) The undersigned registrant hereby undertakes to provide to the Underwriters at the closing specified in the Underwriting Agreement certificates in such denominations and registered in such names as required by the Underwriters to permit prompt delivery to each purchaser.

#### II-2

(b) Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

(c) The undersigned registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b) (1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it is declared effective.

(2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

#### II-3

## SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the Registrant

has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Manhattan Beach, State of California on July 29, 1998.

SKECHERS U.S.A., INC.

By: /s/ ROBERT GREENBERG

-----  
 Robert Greenberg  
 Chairman of the Board  
 and Chief Executive Officer

POWER OF ATTORNEY

We, the undersigned officers and directors of Skechers U.S.A., Inc., do hereby constitute and appoint Robert Greenberg, Michael Greenberg and David Weinberg, or either of them, our true and lawful attorneys and agents, to do any and all acts and things in our names in the capacities indicated below, which said attorneys and agents, or either of them, may deem necessary or advisable to enable said corporation to comply with the Securities Act of 1933, as amended, and any rules, regulations, and requirements of the Securities and Exchange Commission, in connection with this Registration Statement, including specifically, but without limitation, power and authority to sign for us or any of us in our names and in the capacities indicated below, any and all amendments (including post-effective amendment) to this Registration Statement, or any related registration statement that is to be effective upon filing pursuant to Rule 462(b) under the Securities Act of 1933, as amended; and we do hereby ratify and confirm all that the said attorneys and agents, or either of them, shall do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement has been signed by the following persons in the capacity indicated on July 29, 1998.

<TABLE>

<CAPTION>

SIGNATURE -----	TITLE -----
<C> /s/ ROBERT GREENBERG ----- Robert Greenberg	<S> Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
/s/ MICHAEL GREENBERG ----- Michael Greenberg	President and Director
/s/ DAVID WEINBERG ----- David Weinberg	Executive Vice President, Chief Financial Officer and Director (Principal Financial and Accounting Officer)

</TABLE>

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SCHEDULE II

SKECHERS U.S.A., INC.

VALUATION AND QUALIFYING ACCOUNTS  
 YEARS ENDED DECEMBER 31, 1995, 1996 AND 1997

<TABLE>

<CAPTION>

DESCRIPTIONS -----	BALANCE AT BEGINNING	CHARGED TO OF PERIOD	DEDUCTIONS AND	AND WRITE-OFFS	BALANCE AT END OF PERIOD
	<C>	<C>	<C>	<C>	
As of December 31, 1995					
Allowance for obsolescence.....	\$115,000	\$ 873,000	\$ --	\$ 988,000	
Allowance for doubtful accounts.....	312,000	356,000	(302,000)	366,000	
Reserve for sales returns and					

allowances.....	152,000	7,034,000	(6,380,000)	806,000
As of December 31, 1996				
Allowance for obsolescence.....	988,000	420,000	(500,000)	908,000
Allowance for doubtful accounts.....	366,000	623,000	(694,000)	295,000
Reserve for sales returns and allowances.....	806,000	5,517,000	(5,498,000)	825,000
As of December 31, 1997				
Allowance for obsolescence.....	908,000	554,000	(554,000)	908,000
Allowance for doubtful accounts.....	295,000	1,878,000	(908,000)	1,265,000
Reserve for sales returns and allowances.....	825,000	5,463,000	(5,563,000)	725,000

</TABLE>

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INDEX TO EXHIBITS

<TABLE>

<CAPTION>

EXHIBIT

NUMBER

DESCRIPTION OF EXHIBIT

<C> <S>

- 1.1\* Form of Underwriting Agreement
- 2.1\* Agreement of Reorganization and Plan of Merger
- 3.1 Certificate of Incorporation
- 3.2 Bylaws
- 4.1\* Form of Specimen Stock Certificate
- 5.1\* Opinion of Freshman, Marantz, Orlanski, Cooper & Klein, a law corporation
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- 10.2\* 1998 Employee Stock Purchase Plan
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- 10.4\* Form of Employment Agreement between the Registrant and Michael Greenberg
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- 23.2\* Consent of Freshman, Marantz, Orlanski, Cooper & Klein (contained in exhibit 5.1)
- 24.1 Power of attorney (included on signature page of Registration Statement)
- 27 Financial Data Schedules

99.1 Consent of Richard Siskind as Nominated Director  
</TABLE>

-----  
\* To be filed by amendment

STATE OF DELAWARE  
OFFICE OF THE SECRETARY OF STATE

---

I, EDWARD J. FREEL, SECRETARY OF STATE OF THE STATE OF DELAWARE, DO HEREBY CERTIFY THE ATTACHED IS A TRUE AND CORRECT COPY OF THE RESTATED CERTIFICATE OF "SKECHERS U.S.A., INC.", FILED IN THIS OFFICE ON THE SEVENTEENTH DAY OF JULY, A.D. 1998, AT 9 O'CLOCK A.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE KENT COUNTY RECORDER OF DEEDS.

/s/ EDWARD F. FREEL

-----  
[SEAL] Edward J. Freel, Secretary of State

2902395 8100 AUTHENTICATION: 9206024

981278440 DATE: 07-20-98  
AMENDED AND RESTATED

CERTIFICATE OF INCORPORATION

OF

SKECHERS U.S.A., INC.

SKECHERS U.S.A, INC., a corporation organized and existing under the laws of the State of Delaware, hereby certifies as follows:

1. The name of the corporation is SKECHERS U.S.A., INC. The corporation was originally incorporated under the same name and the original Certificate of Incorporation of the corporation was filed with the Secretary of State of the State of Delaware on May 28, 1998.
2. This Amended and Restated Certificate of Incorporation has been duly adopted in accordance with the provisions of Section 241 of the General Corporation Law of the State of Delaware by the Sole Incorporator.
3. Pursuant to Sections 241 and 245 of the General Corporation Law of the State of Delaware, this Certificate of Incorporation restates and integrates and further amends the provisions of the Certificate of Incorporation of this corporation.
4. No directors were named in the original Certificate of Incorporation and none

have been elected. No shares have been issued.

5. The text of the Certificate of Incorporation is hereby amended and restated in its entirety to read as follows:

#### ARTICLE I

The name of this corporation is SKECHERS U.S.A., INC.

#### ARTICLE II

The address of the registered office of the Corporation in the State of Delaware is at 15 East North Street, Dover, Delaware 19901, County of Kent, and the name of its registered agent at that address is Paracorp Incorporating Services.

#### ARTICLE III

The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware.

#### ARTICLE IV

Section 1. Number of Authorized Shares. The total number of shares of stock which the Corporation shall have the authority to issue shall be One Hundred Ten Million (110,000,000) shares. The Corporation shall be authorized to issue two classes of shares of stock, designated, "Common Stock" and "Preferred Stock." The Corporation shall be authorized to issue One Hundred Million (100,000,000) shares of Common Stock, each share to have a par value of \$.001 per share, and Ten Million (10,000,000) shares of Preferred Stock, each share to have a par value of \$.001 per share.

Section 2. Common Stock. The Board of Directors of the Corporation may authorize the issuance of shares of Common Stock from time to time. The Corporation may reissue shares of Common Stock that are redeemed, purchased, or otherwise acquired by the Corporation unless otherwise provided by law.

Section 3. Preferred Stock. The Board of Directors of the Corporation may by resolution authorize the issuance of shares of Preferred Stock from time to time in one or more series. The Corporation may reissue shares of Preferred Stock that are redeemed, purchased, or otherwise acquired by the Corporation unless otherwise provided by law. The Board of Directors is hereby authorized to fix or alter the designations, powers and preferences, and relative, participating, optional or other rights, if any, and qualifications, limitations or restrictions thereof, including, without limitation, dividend rights (and whether dividends are cumulative), conversion rights, if any, voting rights (including the number of votes, if any, per share, as well as the number of members, if any, of the Board of Directors or the percentage of members, if any, of the Board of Directors each class or series of Preferred Stock may be entitled to elect), rights and terms of redemption (including sinking fund provisions, if any), redemption price and liquidation preferences of any wholly unissued series of Preferred Stock, and the number of shares constituting any such series and the designation thereof, and to increase or decrease the number of shares of any such series subsequent to the issuance of shares of such series, but not below the number of shares of such series then outstanding.

Section 4. Dividends and Distributions. Subject to the preferences applicable to Preferred Stock outstanding at any time, the holders of shares of Common Stock shall be entitled to receive such dividends, payable in cash or otherwise, as may be declared thereon by the Board of Directors from time to time out of assets or funds of the Corporation legally available therefor.

Section 5. Voting Rights. Each share of Common Stock shall entitle the holder thereof to one vote on all matters submitted to a vote of the stockholders of the Corporation.

#### ARTICLE V

Meetings of stockholders may be held within or without the State of Delaware, as the Bylaws may provide. The books of the Corporation may be kept

(subject to any provision contained in Delaware General Corporation Law) outside the State of Delaware at such place or places as may be designated from time to time by the Board of directors or in the Bylaws of the Corporation.

#### ARTICLE VI

The number of directors of the Corporation shall be fixed from time to time by or in the manner provided in the Bylaws of the Corporation or amendment thereof duly adopted by the Board of Directors or by the stockholders of the Corporation. Elections of directors need not be by written ballot unless the Bylaws of the Corporation shall so provide.

#### ARTICLE VII

No action, which has not been previously approved by the Board of Directors, shall be taken by the stockholders except at an annual meeting or a special meeting of the stockholders.

#### ARTICLE VIII

To the fullest extent permitted by the Delaware General Corporation Law, as the same exists or may hereafter be amended (provided that the effect of any such amendment shall be prospective only) the "Delaware Law"), a director of the Corporation shall not be liable to the Corporation or its stockholders for monetary damages for breach of his or her fiduciary duty as a director. The Corporation shall indemnify, in the manner and to the fullest extent permitted by the Delaware Law (but in the case of any such amendment, only to the extent that such amendment permits the Corporation to provide broader indemnification rights than permitted prior thereto), any person (or the estate of any person) who is or was a party to, or is threatened to be made a party to, any threatened, pending or completed action, suit or proceeding, whether or not by or in the right of the Corporation, and whether civil, criminal, administrative, investigative or otherwise, by reason of the fact that such person is or was a director or officer of the Corporation, or is or was serving at the request of the Corporation as a director or officer of another corporation, partnership, joint venture, trust or other enterprise. The Corporation to the fullest extent permitted by the Delaware Law, purchase and maintain insurance on behalf of any such person against any liability which may be asserted against such person. The Corporation may create a trust fund, grant a security interest or use other means (including without limitation a letter of credit) to ensure the payment of such sums as may become necessary or desirable to effect the indemnification as provided herein. To the fullest extent permitted by the Delaware Law, the indemnification provided herein shall include expenses as incurred (including attorneys' fees), judgments, finds and amounts paid in settlement and any such expenses shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of the person seeking indemnification to repay such amounts if it is ultimately determined that he or she is not entitled to be indemnified. Notwithstanding the foregoing or any other provision of this Article, no

advance shall be made by the Corporation if a determination is reasonably and promptly made by the Board by a majority vote of a quorum of disinterested Directors, or (if such a quorum is not obtainable or, even if obtainable, a quorum of disinterested Directors so directs) by independent legal counsel to the Corporation, that, based upon the facts known to the Board or such counsel at the time such determination is made, (a) the party seeking an advance acted in bad faith or deliberately breached his or her duty to the Corporation or its stockholders, and (b) as a result of such actions by the party seeking an advance, it is more likely than not that it will ultimately be determined that such party is not entitled to indemnification pursuant to the provisions of this Article VIII. The indemnification provided herein shall not be deemed to limit the right of the Corporation to indemnify any other person for any such expenses to the fullest extent permitted by the Delaware Law, nor shall it be deemed exclusive of any other rights to which any person seeking indemnification from the Corporation may be entitled under any agreement, the Corporation's Bylaws, vote of stockholders or disinterested directors, or otherwise, both as to action in such person's official capacity and as to action in another capacity while holding such office. The Corporation may, but only to the extent that the Board of Directors may (but shall not be obligated to) authorize from time to time, grant rights to indemnification and to the advancement of expenses to any employee or agent of the Corporation to the fullest extent of the provisions of this Article VIII as it applies to the indemnification and advancement of



expenses of directors and officers of the Corporation.

The undersigned Sole Incorporator hereby acknowledges that the foregoing Amended and Restated Certificate of Incorporation is her act and deed and that the facts stated therein are true.

/s/ KASEY HANNAH

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Kasey Hannah  
Sole Incorporator

Exhibit 3.2

SKECHERS U.S.A., INC.  
A DELAWARE CORPORATION

BYLAWS

ARTICLE I: OFFICES

SECTION 1.1 Registered Office. The registered office of Skechers U.S.A., Inc., (the "Corporation") shall be at 15 East North Street, Dover, Delaware 19901, and the name of its registered agent at that address is Paracorp Incorporated.

SECTION 1.2 Principal Office. The principal office for the transaction of the business of the Corporation shall be at 228 Manhattan Beach Blvd., Suite 200, Manhattan Beach, California 90266 or otherwise as set forth in a resolution adopted by the Board.

SECTION 1.3 Other Offices. The Corporation may also have an office or offices at such other place or places, either within or without the State of Delaware, as the Board may from time to time determine or as the business of the Corporation may require.

ARTICLE II: MEETINGS OF STOCKHOLDERS

SECTION 2.1 Place of Meetings. All annual meetings of stockholders and all other meetings of stockholders shall be held either at the principal office of the Corporation or at any other place within or without the State of Delaware that may be designated by the Board pursuant to authority hereinafter granted to the Board.

SECTION 2.2 Annual Meetings. Annual meetings of stockholders of the Corporation for the purpose of electing directors and for the transaction of such other business as may properly come before such meetings may be held at such time and place and on such date as the Board shall determine by resolution.

SECTION 2.3 Special Meetings. A special meeting of the stockholders for the transaction of any proper business may be called at any time exclusively by the Board or the Chairman.

SECTION 2.4 Notice of Meetings. Except as otherwise required by law, notice of each meeting of stockholders, whether annual or special, shall be given not less than ten (10) days nor more than sixty (60) days before the date of the meeting to each stockholder of record entitled to vote at such meeting by delivering a typewritten or printed notice thereof to such stockholder personally, or by depositing such notice in the United States mail, in a postage prepaid envelope, directed to such stockholder at such stockholder's post office address furnished by such stockholder to the Secretary of the Corporation for such purpose, or, if such stockholder shall not have furnished an address to the Secretary for such purpose, then at such stockholder's post office address last known to the Secretary, or by transmitting a notice thereof to such stockholder at such address by telegraph, cable, wireless or facsimile. Except as otherwise expressly required by

law, no publication of any notice of a meeting of stockholders shall be required. Every notice of a meeting of stockholders shall state the place, date and hour of the meeting and, in the case of a special meeting, shall also state the purpose for which the meeting is called. Notice of any meeting of stockholders shall not be required to be given to any stockholder to whom notice may be omitted pursuant to applicable Delaware law or who shall have waived such notice, and such notice shall be deemed waived by any stockholder who shall attend such meeting in person or by proxy, except a stockholder who shall attend such meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Except as otherwise expressly required by law, notice of any adjourned meeting of stockholders need not be given if the time and place thereof are announced at the meeting at which the adjournment is taken.

SECTION 2.5 Fixing Date for Determination of Stockholders of Record. In order

that the Corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any other change, conversion or exchange of stock or for the purpose of any other lawful action other than to consent to corporate action in writing without a meeting, the Board may fix, in advance, a record date, which shall not be more than sixty (60) nor less than ten (10) days before the date of such meeting, nor more than sixty (60) days prior to any such other action. If in any case involving the determination of stockholders for any purpose other than notice of or voting at a meeting of stockholders the Board shall not fix such a record date, then the record date for determining stockholders for such purpose shall be the close of business on the day on which the Board shall adopt the resolution relating thereto. A determination of stockholders entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of such meeting; provided, however, that the Board may fix a new record date for the adjourned meeting.

SECTION 2.6 Quorum. Except as otherwise required by law, the holders of record of a majority in voting interest of the shares of stock of the Corporation entitled to be voted thereat, present in person or by proxy, shall constitute a quorum for the transaction of business at any meeting of stockholders of the Corporation or any adjournment thereof. Subject to the requirement of a larger percentage vote, if any, contained in the Certificate of Incorporation, these Bylaws or by statute, the stockholders present at a duly called or held meeting at which a quorum is present may continue to do business until adjournment, notwithstanding any withdrawal of stockholders that may leave less than a quorum remaining, if any action taken (other than adjournment) is approved by the vote of at least a majority in voting interest of the shares required to constitute a quorum. In the absence of a quorum at any meeting or any adjournment thereof, a majority in voting interest of the stockholders present in person or by proxy and entitled to vote thereat or, in the absence therefrom of all the stockholders, any officer entitled to preside at, or to act as secretary of, such meeting may adjourn such meeting from time to time. At any such adjourned meeting at which a quorum is present, any business may be transacted that might have been transacted at the meeting as originally called.

#### SECTION 2.7 Voting.

(A) Each stockholder shall, at each meeting of stockholders, be entitled to vote, in the manner prescribed by the Corporation's Certificate of Incorporation, in person or by proxy each share of the stock of the Corporation that has voting rights on the matter in question and that shall have been held by such stockholder and registered in such stockholder's name on the books of the Corporation:

(i) on the date fixed pursuant to Section 2.5 of these Bylaws as the record date for the determination of stockholders entitled to notice of and to vote at such meeting; or

(ii) if no such record date shall have been so fixed, then (a) at the close of business on the business day next preceding the day upon which notice of the meeting shall be given or (b) if notice of the meeting shall be waived, at the close of business on the business day next preceding the day upon which the meeting shall be held.

(B) Shares of the Corporation's own stock belonging to the Corporation or to another corporation, if a majority of the shares entitled to vote in the election of directors in such other corporation is held, directly or indirectly, by the Corporation, shall neither be entitled to vote nor be counted for quorum purposes. Persons holding stock of the Corporation in a fiduciary capacity shall be entitled to vote such stock. Persons whose stock is pledged shall be entitled to vote, unless in the transfer by the pledgor on the books of the Corporation the pledgor shall have expressly empowered the pledgee to vote thereon, in which case only the pledgee, or the pledgee's proxy, may represent such stock and vote thereon. Stock having voting power standing of record in the names of two or more persons, whether fiduciaries, members of a partnership, joint tenants,

tenants in common, tenants by the entirety or otherwise, or with respect to which two or more persons have the same fiduciary relationship, shall be voted in accordance with the provisions of the Delaware General Corporation Law, as the same exists or may hereafter be amended (the "DGCL").

(C) Subject to the provisions of the Corporation's Certificate of Incorporation, any such voting rights may be exercised by the stockholder entitled thereto in person or by such stockholder's proxy appointed by an instrument in writing, subscribed by such stockholder or by such stockholder's attorney thereunto authorized and delivered to the secretary of the meeting. The attendance at any meeting of a stockholder who may theretofore have given a proxy shall not have the effect of revoking the same unless such stockholder shall in writing so notify the secretary of the meeting prior to the voting of the proxy. At any meeting of stockholders at which a quorum is present, all matters, except as otherwise provided in the Certificate of Incorporation, in these Bylaws or by law, shall be decided by the vote of a majority in voting interest of the stockholders present in person or by proxy and entitled to vote thereat and thereon. The vote at any meeting of stockholders on any question need not be by ballot, unless so directed by the chairman of the meeting. On a vote by ballot, each ballot shall be signed by the stockholder voting, or by such stockholder's proxy, if there be such proxy, and it shall state the number of shares voted.

SECTION 2.8 Judges. Prior to each meeting of stockholders, the Chairman of such meeting shall appoint a judge or judges to act with respect to any vote. Each judge so appointed shall first subscribe an oath faithfully to execute the duties of a judge at such meeting with strict impartiality and according to the best of such judge's ability. Such judges shall decide upon the qualification of the voters and shall certify and report the number of shares represented at the meeting and entitled to vote on any question, determine the number of votes entitled to be cast by each share, shall conduct the vote and, when the voting is completed, accept the votes and ascertain and report the number of shares voted respectively for and against each question, and determine, and retain for a reasonable period a record of the disposition of, any challenge made to any determination made by such judges. Reports of judges shall be in writing and subscribed and delivered by them to the Secretary of the Corporation. The judges need not be stockholders of the Corporation, and any officer of the Corporation may be a judge on any question other than a vote for or against a proposal in which such officer shall have a material interest. The judges may appoint or retain other persons or entities to assist the judges in the performance of the duties of the judges.

SECTION 2.9 Advance Notice of Stockholder Proposals and Stockholder Nominations.

(A) At any meeting of the stockholders, only such business shall be conducted as shall have been brought before the meeting (i) by or at the direction of the Board or (ii) by any stockholder of the Corporation who complies with the notice procedures set forth in this Section 2.9(A). For business to be properly brought before any meeting of the stockholders by a stockholder, the stockholder must have given notice thereof in writing to the Secretary of the Corporation not less than ninety (90) days in advance of such meeting or, if later, the seventh day following the first public announcement of the date of such meeting. A stockholder's notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the meeting (1) a brief description of the business desired to be brought before the meeting and the reasons for conducting such business at the meeting, (2) the name and address, as they appear on the Corporation's books, of the stockholder proposing such business, (3) the class and number of shares of the Corporation that are beneficially owned by the stockholder, and (4) any material interest of the stockholder in such business. In addition, the stockholder making such proposal shall promptly provide any other information reasonably requested by the Corporation. Notwithstanding anything in these Bylaws to the contrary, no business shall be conducted at any meeting of the stockholders except in accordance with the procedures set forth in this Section 2.9. The Chairman of any such meeting shall direct that any business not properly brought before the meeting shall not be considered.

(B) Nominations for the election of directors may be made by the Board or by any stockholder entitled to vote in the election of directors; provided, however, that a stockholder may nominate a person for election as a director at a meeting only if written notice of such stockholder's intent to make such nomination has been given to the Secretary of the Corporation not later than ninety (90) days

in advance of such meeting or, if later, the seventh day following the first public announcement of the date of such meeting. Each such notice shall set forth: (i) the name and address of the stockholder who intends to make the nomination and of the person or persons to be nominated; (ii) a representation that the stockholder is a holder of record of stock of the

Corporation entitled to vote at such meeting and intends to appear in person or by proxy at the meeting and nominate the person or persons specified in the notice; (iii) a description of all arrangements or understandings between the stockholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by the stockholder; (iv) such other information regarding each nominee proposed by such stockholder as would be required to be included in a proxy statement filed pursuant to the proxy rules of the United States Securities and Exchange Commission had the nominee been nominated, or intended to be nominated, by the Board; and (v) the consent of each nominee to serve as a director of the Corporation if so elected. In addition, the stockholder making such nomination shall promptly provide any other information reasonably requested by the Corporation. No person shall be eligible for election as a director of the Corporation unless nominated in accordance with the procedures set forth in this Section 2.9(B). The Chairman of any meeting of stockholders shall direct that any nomination not made in accordance with these procedures be disregarded.

SECTION 2.10 Action Without Meeting. Any action required to be taken at any annual or special meeting of stockholders of the Corporation, or any action which may be taken at any annual or special meeting of such stockholders, may, if such action has been earlier approved by the Board, be taken without a meeting, without prior notice and without a vote, if a consent in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. Prompt notice of the taking of the corporate action without a meeting by less than unanimous written consent shall be given to those stockholders who have not consented in writing.

### ARTICLE III: BOARD OF DIRECTORS

SECTION 3.1 General Powers. Subject to any requirements in the Certificate of Incorporation, these Bylaws, or of the DGCL as to action which must be authorized or approved by the stockholders, any and all corporate powers shall be exercised by or under the authority of, and the business and affairs of the Corporation shall be under the direction of, the Board to the fullest extent permitted by law. Without limiting the generality of the foregoing, it is hereby expressly declared that the Board shall have the following powers, to wit:

(A) to select and remove all the officers, agents and employees of the Corporation, prescribe such powers and duties for them as may not be inconsistent with law, the Certificate of Incorporation or these Bylaws, fix their compensation, and require from them security for faithful service;

(B) to conduct, manage and control the affairs and business of the Corporation, and to make such rules and regulations therefor not inconsistent with law, the Certificate of Incorporation or these Bylaws, as it may deem best;

(C) to change the location of the registered office of the Corporation in Section 1.1 hereof; to change the principal office and the principal office for the transaction of the business of the

Corporation from one location to another as provided in Section 1.2 hereof; to fix and locate from time to time one or more offices of the Corporation within or without the State of Delaware as provided in Section 1.3 hereof; to designate any place within or without the State of Delaware for the holding of any meeting or meetings of stockholders; and to adopt, make and use a corporate seal, and to prescribe the forms of certificates of stock, and to alter the form of such seal and of such certificates from time to time, and in its judgment as it may deem

best, provided such seal and such certificate shall at all times comply with the provisions of law;

(D) to authorize the issuance of shares of stock of the Corporation from time to time, upon such terms and for such considerations as may be lawful;

(E) to borrow money and incur indebtedness for the purposes of the Corporation, and to cause to be executed and delivered therefor, in the corporate name, promissory notes, bonds, debentures, deeds of trust and securities therefor; and

(F) by resolution adopted by a majority of the whole Board to designate an executive and other committees of the Board, each consisting of one or more directors, to serve at the pleasure of the Board, and to prescribe the manner in which proceedings of such committee or committees shall be conducted.

#### SECTION 3.2 Number and Term of Office.

(A) Until this Section 3.2 is amended by a resolution duly adopted by the Board or by the stockholders of the Corporation, the number of directors constituting the entire Board shall be not less than five (5) members nor more than nine (9) members and shall initially consist of five (5) members. Directors need not be stockholders. Each of the directors of the Corporation shall hold office until his successor shall have been duly elected or until he shall resign or shall have been removed in the manner hereinafter provided.

(B) The Board shall be divided into three classes: Class I, Class II and Class III. Each Director shall serve for a term ending on the date of the third annual meeting following the annual meeting at which such director was elected; provided, however, that the directors first elected to Class I shall serve for a term ending on the date of the annual meeting next following the end of the calendar year 1998, the director first elected to Class II shall serve for a term ending on the date of the second annual meeting next following the end of the calendar year 1998, and the directors first elected to Class III shall serve for a term ending on the date of the third annual meeting next following the end of the calendar year 1998. Notwithstanding the foregoing provisions of this Article, each director shall serve until his successor is duly elected and qualified or until his death, resignation or removal. No decrease in the number of directors constituting the Board of Directors shall shorten the term of an incumbent director.

SECTION 3.3 Chairman of the Board. The Chairman of the Board, when present, shall preside at all meetings of the Board and all meetings of stockholders. The Chairman of the Board shall perform other duties commonly incident to his office and shall also perform such other duties and have such other powers as the Board of Directors shall designate from time to time.

SECTION 3.4 Election of Directors. The directors shall be elected by the stockholders of the Corporation, and at each election, the persons receiving the greater number of votes, up to the number of directors then to be elected, shall be the persons then elected. The election of directors is subject to any provision contained in the Certificate of Incorporation relating thereto, including any provision regarding the rights of holders of preferred stock to elect directors.

SECTION 3.5 Resignations. Any director of the Corporation may resign at any time by giving written notice to the Board or to the Secretary of the Corporation. Any such resignation shall take effect at the time specified therein, or, if the time is not specified, it shall take effect immediately upon receipt; and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

SECTION 3.6 Vacancies. Except as otherwise provided in the Certificate of Incorporation, any vacancy in the Board, whether because of death, resignation, disqualification, an increase in the number of directors, removal, or any other cause, may be filled by vote of the majority of the remaining directors, although less than a quorum. Increases in the number of directors shall be filled in accordance with the rule that each class of directors shall be as

nearly equal in number of directors as possible. Notwithstanding such rule, in the event of any change in the authorized number of directors each director then continuing to serve as such will nevertheless continue as a director of the class of which he is a member, until the expiration of his current term or his earlier death, resignation or removal. If any newly created directorship or vacancy on the Board, consistent with the rule that the three classes shall be as nearly equal in number of directors as possible, may be allocated to one or two or more classes, the Board shall allocate it to that of the available class whose term of office is due to expire at the earliest date following such allocation. When the Board fills a vacancy, the director chosen to fill that vacancy shall be of the same class as the director he succeeds and shall hold office until such director's successor shall have been elected and shall qualify or until such director shall resign or shall have been removed. No reduction of the authorized number of directors shall have the effect of removing any director prior to the expiration of such director's term of office.

SECTION 3.7 Place of Meeting. The Board or any committee thereof may hold any of its meetings at such place or places within or without the State of Delaware as the Board or such committee may from time to time by resolution designate or as shall be designated by the person or persons calling the meeting or in the notice or a waiver of notice of any such meeting. Directors may participate in any regular or special meeting of the Board or any committee thereof by means of conference telephone or similar communications equipment pursuant to which all persons participating in the meeting of the Board or such committee can hear each other, and such participation shall constitute presence in person at such meeting.

SECTION 3.8 Regular Meetings. Regular meetings of the Board may be held at such times as the Board shall from time to time by resolution determine.

SECTION 3.9 Special Meetings. Special meetings of the Board for any purpose or purposes shall be called at any time by the Chairman of the Board or, if the Chairman of the Board is absent or unable or refuses to act, by the President, and may also be called by any two members of the Board. Except as otherwise provided by law or by these Bylaws, written notice of the time and place of special meetings shall be delivered personally or by facsimile to each director, or sent to each director by mail or by other form of written communication, charges prepaid, addressed to such director at such director's address as it is shown upon the records of the Corporation, or, if it is not so shown on such records and is not readily ascertainable, at the place in which the meetings of the directors are regularly held. In case such notice is mailed or telegraphed, it shall be deposited in the United States mail or delivered to the telegraph company in the County in which the principal office for the transaction of the business of the Corporation is located at least 48 hours prior to the time of the holding of the meeting. In case such notice is delivered personally or by facsimile as above provided, it shall be delivered at least 24 hours prior to the time of the holding of the meeting. Such mailing, telegraphing, delivery or facsimile transmission as above provided shall be due, legal and personal notice to such director. Except where otherwise required by law or by these Bylaws, notice of the purpose of a special meeting need not be given. Notice of any meeting of the Board shall not be required to be given to any director who is present at such meeting, except a director who shall attend such meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

SECTION 3.10 Quorum and Manner of Acting. Except as otherwise provided in these Bylaws, the Certificate of Incorporation or by applicable law, the presence of a majority of the authorized number of directors shall be required to constitute a quorum for the transaction of business at any meeting of the Board, and all matters shall be decided at any such meeting, a quorum being present, by the affirmative votes of a majority of the directors present. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, provided any action taken is approved by at least a majority of the required quorum for such meeting. In the absence of a quorum, a majority of directors present at any meeting may adjourn the same from time to time until a quorum shall be present. Notice of any adjourned meeting need not

be given. The directors shall act only as a Board, and the individual directors shall have no power as such.

SECTION 3.11 Action by Unanimous Written Consent. Any action required or permitted to be taken at any meeting of the Board or of any committee thereof may be taken without a meeting if consent in writing is given thereto by all members of the Board or of such committee, as the case may be, and such consent is filed with the minutes of proceedings of the Board or of such committee.

SECTION 3.12 Compensation. Directors, whether or not employees of the Corporation or any of its subsidiaries, may receive an annual fee for their services as directors in an amount fixed by resolution of the Board plus other compensation, including options to acquire capital stock of the Corporation, in an amount and of a type fixed by resolution of the Board, and, in addition, a fixed fee, with or without expenses of attendance, may be allowed by resolution of the Board for attendance at each meeting, including each meeting of a committee of the Board. Nothing herein contained shall be construed to preclude any director from serving the Corporation in any other capacity as an officer, agent, employee, or otherwise, and receiving compensation therefor.

SECTION 3.13 Committees. The Board may, by resolution passed by a majority of the whole Board, designate one or more committees, each committee to consist of one or more of the directors of the Corporation. Any such committee, to the extent provided in the resolution of the Board and subject to any restrictions or limitations on the delegation of power and authority imposed by applicable law, shall have and may exercise all the powers and authority of the Board in the management of the business and affairs of the Corporation, and may authorize the seal of the Corporation to be affixed to all papers which may require it. Any such committee shall keep written minutes of its meetings and report the same to the Board at the next regular meeting of the Board. Unless the Board or these Bylaws shall otherwise prescribe the manner of proceedings of any such committee, meetings of such committee may be regularly scheduled in advance and may be called at any time by the chairman of the committee or by any two members thereof; otherwise, the provisions of these Bylaws with respect to notice and conduct of meetings of the Board shall govern.

SECTION 3.14 Affiliated Transactions. Notwithstanding any other provision of these Bylaws, each transaction, or, if an individual transaction constitutes a part of a series of transactions, each series of transactions, proposed to be entered into between the Corporation, on the one hand, and any affiliate of the Corporation, on the other hand, must be approved by a majority of the Independent Directors. Notwithstanding any other provision of these Bylaws, this Section 3.14 may only be amended by the vote of the majority of the Independent Directors. For the purposes of this Section 3.14, (a) "affiliate" shall mean (i) any person that, directly or indirectly, controls or is controlled by or is under common control with such person, (ii) any other person that owns, beneficially, directly or indirectly, twenty percent (20%) or more of the outstanding capital shares, shares or equity interests of such person, or (iii) any officer, director, employee, partner or trustee of such person or any person controlling, controlled by or under common control with such person (excluding trustees and persons serving in similar capacities who are not otherwise an Affiliate of such person); (b) "person" shall mean and include individuals, corporations, general and limited partnerships, stock companies or associations, joint ventures, associations, companies, trusts, banks, trust companies, land trusts, business trusts or other entities and governments and agencies and political subdivisions thereof; (c) "control" (including the correlative meanings of the terms "controlled by" and "under common control with"), as used with respect to any person, shall mean the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such person, through the ownership of voting securities, partnership interests or other equity interests; and (d) Independent Director shall mean a Director who is not an officer or employee of the Corporation or any of its subsidiaries.



## ARTICLE IV: OFFICERS

SECTION 4.1 Officers. The officers of the Corporation shall be a Chief Executive Officer, a President, one or more Vice Presidents (the number thereof and their respective titles to be determined by the Board), a Secretary, a Chief Financial Officer, and such other officers as may be appointed at the discretion of the Board in accordance with the provisions of Section 4.3 hereof.

SECTION 4.2 Election. The officers of the Corporation, except such officers as may be appointed or elected in accordance with the provisions of Sections 4.3 or 4.5 hereof, shall be chosen annually by the Board at the first meeting thereof after the annual meeting of stockholders, and each officer shall hold office until such officer shall resign or shall be removed or otherwise disqualified to serve, or until such officer's successor shall be elected and qualified.

SECTION 4.3 Other Officers. In addition to the officers chosen annually by the Board at its first meeting, the Board also may appoint or elect such other officers as the business of the Corporation may require, each of whom shall have such authority and perform such duties as are provided in these Bylaws or as the Board may from time to time specify, and shall hold office until such officer shall resign or shall be removed or otherwise disqualified to serve, or until such officer's successor shall be elected and qualified.

SECTION 4.4 Removal and Resignation. Except as provided by DGCL Section 141(k), any officer may be removed, either with or without cause, by resolution of the Board, at any regular or special meeting of the Board, or except in case of an officer chosen by the Board, by any officer upon whom such power of removal may be conferred by the Board. Any officer or assistant may resign at any time by giving written notice of his resignation to the Board or the Secretary of the Corporation. Any such resignation shall take effect at the time specified therein, or, if the time is not specified, upon receipt thereof by the Board or the Secretary, as the case may be; and, unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective.

SECTION 4.5 Vacancies. A vacancy in any office because of death, resignation, removal, disqualification or any other cause shall be filled in the manner prescribed in these Bylaws for regular appointments to such office.

SECTION 4.6 Chief Executive Officer. The Chief Executive Officer shall preside at all meetings of the stockholders and at all meetings of the Board of Directors, unless the Chairman of the Board has been appointed and is present. The Chief Executive Officer shall be the chief executive officer of the Corporation and shall, subject to the control of the Board of Directors, have general supervision, direction and control of the business and affairs of the Corporation. The Chief Executive Officer shall also perform such other duties and have such other powers as the Board of Directors may designate from time to time.

SECTION 4.7 President. The President shall preside at all meetings of the stockholders and at all meetings of the Board of Directors, unless the Chairman of the Board has been appointed and is present or, in the absence of the Chairman of the Board, the Chief Executive Officer has been appointed and is present. Subject to the provisions of these Bylaws and to the direction of the Board of Directors and Chief Executive Officer, the President shall have the responsibility for the general management and control of the business and affairs of the Corporation and shall perform all duties and have all powers which are commonly incident to the office of President or which are delegated to him by the Board of Directors. The President shall have the power to sign all stock certificates, contracts and other instruments of the Corporation which are authorized and shall have general supervision and direction of all the other officers, employees and agents of the corporation.

SECTION 4.8 Vice President. Each Vice President shall have such powers and perform such duties with respect to the administration of the business and affairs of the Corporation as are commonly incident to their office or as may

from time to time be assigned to such Vice President by the Chairman of the Board, or the Board, or the President, or as may be prescribed by these Bylaws. In the absence or disability of the Chairman of the Board and the President, the Vice Presidents in order of their rank as fixed by the Board, or if not ranked, the Vice President designated by the Board, shall perform all of the duties of the Chairman of the Board, and when so acting shall have all the powers of, and be subject to all the restrictions upon, the Chairman of the Board.

#### SECTION 4.9 Secretary.

(A) The Secretary shall attend all meetings of the stockholders and of the Board of Directors and shall record all acts and proceedings thereof in the minute book of the Corporation. The Secretary shall give notice in conformity with these Bylaws of all meetings of the stockholders and of all meetings of the Board of Directors and any committee thereof requiring notice. The Secretary shall perform all other duties given him in these Bylaws and other duties commonly incident to his office and shall also perform such other duties and have such other powers as the Board shall designate from time to time.

(B) The Secretary shall keep, or cause to be kept, at the principal office of the Corporation or such other place as the Board may order, a book of minutes of all meetings of directors and stockholders, with the time and place of holding, whether regular or special, and if special, how authorized and the notice thereof given, the names of those present at meetings of directors, the number of shares present or represented at meetings of stockholders, and the proceedings thereof.

(C) The Secretary shall keep, or cause to be kept, at the principal office of the Corporation's transfer agent, a share register, or a duplicate share register, showing the name of each stockholder, the number of shares of each class held by such stockholder, the number and date of certificates issued for such shares, and the number and date of cancellation of every certificate surrendered for cancellation.

SECTION 4.10 Chief Financial Officer. The Chief Financial Officer shall keep or cause to be kept the books of account of the corporation in a thorough and proper manner and shall render statements of the financial affairs of the corporation in such form and as often as required by the Board of Directors or the Chief Executive Officer. The Chief Financial Officer, subject to the order of the Board, shall have the custody of all funds and securities of the Corporation. The Chief Financial Officer shall perform other duties commonly incident to his office and shall also perform such other duties and have such other powers as the Board or the Chief Executive Officer shall designate from time to time.

#### ARTICLE V: CORPORATE INSTRUMENTS, CHECKS, DRAFTS, BANK ACCOUNTS, ETC.

SECTION 5.1 Execution of Corporate Instruments. The Board of Directors may, in its discretion, determine the method and designate the signatory officer or officers, or other person or persons, to execute on behalf of the Corporation the corporate name without limitation, or enter into contracts on behalf of the Corporation, except where otherwise provided by law or these Bylaws, and such execution or signature shall be binding upon the Corporation. Such authority may be general or confined to specific instances, and unless so authorized by the Board or by these Bylaws, no officer, agent, or employee shall have any power or authority to bind the Corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or in any amount.

SECTION 5.2 Checks, Drafts, Etc. All checks, drafts or other orders for payment of money, notes or other evidence of indebtedness, issued in the name of or payable to the Corporation, shall be signed or endorsed by such person or persons and in such manner as, from time to time, shall be determined by resolution of the Board. Each such officer, assistant, agent or attorney shall give such bond, if any, as the Board may require.

SECTION 5.3 Deposits. All funds of the Corporation not otherwise employed shall

be deposited from time to time to the credit of the Corporation in such banks, trust companies or other depositories as the Board may select, or as may be selected by any officer or officers, assistant or assistants, agent or agents, or attorney or attorneys of the Corporation to whom such power shall have been delegated by the Board. For the purpose of deposit and for the purpose of collection for the account of the Corporation, the Chairman of the Board, the Chief Executive Officer, the President, any Vice President (or any other officer or officers, assistant or assistants, agent or agents, or attorney or attorneys of the Corporation who shall from time to time be determined by the Board) may endorse, assign and deliver checks, drafts and other orders for the payment of money which are payable to the order of the Corporation.

SECTION 5.4 General and Special Bank Accounts. The Board may from time to time authorize the opening and keeping of general and special bank accounts with such banks, trust companies or other depositories as the Board may select or as may be selected by any officer or officers, assistant or assistants, agent or agents, or attorney or attorneys of the Corporation to whom such power shall have been delegated by the Board. The Board may make such special rules and

regulations with respect to such bank accounts, not inconsistent with the provisions of these Bylaws, as it may deem expedient.

## ARTICLE VI: SHARES AND THEIR TRANSFER

SECTION 6.1 Certificates for Stock. Every owner of stock of the Corporation shall be entitled to have a certificate or certificates, to be in such form as the Board shall prescribe, certifying the number and class or series of shares of the stock of the Corporation owned by such owner. The certificates representing shares of such stock shall be numbered in the order in which they shall be issued and shall be signed in the name of the Corporation by the Chairman of the Board, the Chief Executive Officer, the President or any Vice President, and by the Secretary. Any or all of the signatures on the certificates may be a facsimile. In case any officer, transfer agent or registrar who has signed, or whose facsimile signature has been placed upon, any such certificate, shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, such certificate may nevertheless be issued by the Corporation with the same effect as though the person who signed such certificate, or whose facsimile signature shall have been placed thereupon, were such an officer, transfer agent or registrar at the date of issue. A record shall be kept of the respective names of the persons, firms or corporations owning the stock represented by such certificates, the number and class or series of shares represented by such certificates, respectively, and the respective dates thereof, and in case of cancellation, the respective dates of cancellation. Every certificate surrendered to the Corporation for exchange or transfer shall be canceled, and no new certificate or certificates shall be issued in exchange for any existing certificate until such existing certificate shall have been so canceled, except in cases provided for in Section 6.4 hereof.

SECTION 6.2 Transfers of Stock. Transfers of shares of stock of the Corporation shall be made only on the books of the Corporation by the registered holder thereof, or by such holder's attorney thereunto authorized by power of attorney duly executed and filed with the Secretary, or with a transfer clerk or a transfer agent appointed as provided in Section 6.3 hereof, and upon surrender of the certificate or certificates for such shares properly endorsed and the payment of all taxes thereon. The person in whose name shares of stock stand on the books of the Corporation shall be deemed the owner thereof for all purposes as regards the Corporation. Whenever any transfer of shares shall be made for collateral security, and not absolutely, such fact shall be so expressed in the entry of transfer if, when the certificate or certificates shall be presented to the Corporation for transfer, both the transferor and the transferee request the Corporation to do so.

SECTION 6.3 Regulations. The Board may make such rules and regulations as it may deem expedient, not inconsistent with these Bylaws, concerning the issue, transfer and registration of certificates for shares of the stock of the Corporation. It may appoint, or authorize any officer or officers to appoint, one or more transfer clerks or one or more transfer agents and one or more registrars, and may require all certificates for stock to bear the signature or

signatures of any of them.

SECTION 6.4 Lost, Stolen, Destroyed, and Mutilated Certificates. In any case of loss, theft, destruction, or mutilation of any certificate of stock, another may be issued in its place upon proof satisfactory to the Board of such loss, theft, destruction, or mutilation and upon the giving of a bond of indemnity to the Corporation in such form and in such sum as the Board may direct; provided, however, that a new certificate may be issued without requiring any bond when, in the judgment of the Board, it is proper so to do.

#### ARTICLE VII: INDEMNIFICATION

SECTION 7.1 Indemnification of Directors and Officers. To the fullest extent permitted by the Delaware General Corporation Law, as the same exists or may hereafter be amended (provided that the effect of any such amendment shall be prospective only) (the "Delaware Law"), a director of the Corporation shall not be liable to the Corporation or its stockholders for monetary damages for breach of his or her fiduciary duty as a director. The Corporation shall indemnify, in the manner and to the fullest extent permitted by the Delaware Law (but in the case of any such amendment, only to the extent that such amendment permits the Corporation to provide broader indemnification rights than permitted prior thereto), any person (or the estate of any person) who is or was a party to, or is threatened to be made a party to, any threatened, pending or completed action, suit or proceeding, whether or not by or in the right of the Corporation, and whether civil, criminal, administrative, investigative or otherwise, by reason of the fact that such person is or was a director or officer of the Corporation, or is or was serving at the request of the Corporation as a director or officer of another corporation, partnership, joint venture, trust or other enterprise. The Corporation may, to the fullest extent permitted by the Delaware Law, purchase and maintain insurance on behalf of any such person against any liability which may be asserted against such person. The Corporation may create a trust fund, grant a security interest or use other means (including without limitation a letter of credit) to ensure the payment of such sums as may become necessary or desirable to effect the indemnification as provided herein. To the fullest extent permitted by the Delaware Law, the indemnification provided herein shall include expenses as incurred (including attorneys' fees), judgments, fines and amounts paid in settlement and any such expenses shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of the person seeking indemnification to repay such amounts if it is ultimately determined that he or she is not entitled to be indemnified. Notwithstanding the foregoing or any other provision of this Section 7.1, no advance shall be made by the Corporation if a determination is reasonably and promptly made by the Board by a majority vote of a quorum of disinterested Directors, or (if such a quorum is not obtainable or, even if obtainable, a quorum of disinterested Directors so directs) by independent legal counsel to the Corporation, that, based upon the facts known to the Board or such counsel at the time such determination is made, (a) the party seeking an advance acted in bad faith or deliberately breached his or her duty to the Corporation or its stockholders, and (b) as a result of such actions by the party seeking an advance, it is more likely than not that it will ultimately be determined that such party is not entitled to indemnification pursuant to the provisions of this Section 7.1. The indemnification provided herein shall not be deemed to limit the right of the Corporation to indemnify any other person for any such expenses to the fullest extent permitted by the Delaware Law, nor shall it be deemed exclusive of any other rights to which any person seeking

indemnification from the Corporation may be entitled under any agreement, the Corporation's Bylaws, vote of stockholders or disinterested directors, or otherwise, both as to action in such person's official capacity and as to action in another capacity while holding such office. The Corporation may, but only to

the extent that the Board of Directors may (but shall not be obligated to) authorize from time to time, grant rights to indemnification and to the advancement of expenses to any employee or agent of the Corporation to the fullest extent of the provisions of this Section 7.1 as it applies to the indemnification and advancement of expenses of directors and officers of the Corporation.

SECTION 7.2 Indemnification of Employees and Agents. Subject to Section 7.1, the Corporation may, but only to the extent that the Board may (but shall not be obligated to) authorize from time to time, grant rights to indemnification and to the advancement of expenses to any employee or agent of the Corporation to the fullest extent of the provisions of this Article VII as they apply to the indemnification and advancement of expenses of directors and officers of the Corporation.

SECTION 7.3 Enforcement of Indemnification. The rights to indemnification and the advancement of expenses conferred above shall be contract rights. If a claim under this Article VII is not paid in full by the Corporation within 60 days after written claim has been received by the Corporation, except in the case of a claim for an advancement of expenses, in which case the applicable period shall be 20 days, the indemnitee may at any time thereafter bring suit against the Corporation to recover the unpaid amount of such claim. If successful in whole or in part in any such suit, or in a suit brought by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking, the indemnitee shall be entitled to be paid also the expenses of prosecuting or defending such suit. In (i) any suit brought by the indemnitee to enforce a right to indemnification hereunder (but not in a suit brought by the indemnitee to enforce a right to an advancement of expenses) it shall be a defense that, and (ii) any suit by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking the Corporation shall be entitled to recover such expenses upon a final adjudication that, the indemnitee has not met any applicable standard for indemnification set forth in the DGCL. Neither the failure of the Corporation (including its Board, independent legal counsel or stockholders) to have made a determination prior to the commencement of such suit that indemnification of the indemnitee is proper in the circumstances because the indemnitee has met the applicable standard of conduct set forth in the DGCL, nor an actual determination by the Corporation (including its Board, independent legal counsel or stockholders) that the indemnitee has not met such applicable standard of conduct, shall either create a presumption that the indemnitee has not met the applicable standard of conduct or, in the case of such a suit brought by the indemnitee, be a defense to such suit. In any suit brought by the indemnitee to enforce a right to indemnification or to an advancement of expenses hereunder, or by the Corporation to recover an advancement of expenses pursuant to the terms of an undertaking, the burden of proving that the indemnitee is not entitled to be indemnified, or to such advancement of expenses, under this Article VII or otherwise shall be on the Corporation.

## ARTICLE VIII: MISCELLANEOUS

SECTION 8.1 Seal. The Board shall adopt a corporate seal, which shall be in the form of two concentric circles with the name of the Corporation between the two circles and the date and state of incorporation appearing in the inner circle.

SECTION 8.2 Waiver of Notices. Whenever notice is required to be given by these Bylaws or the Certificate of Incorporation or by law, the person entitled to said notice may waive such notice in writing, either before or after the time stated therein, and such waiver shall be deemed equivalent to notice.

SECTION 8.3 Amendments. Except as otherwise provided herein or in the Certificate of Incorporation, these Bylaws or any of them may be altered, amended, repealed or rescinded and new Bylaws may be adopted by the Board or by the stockholders at any annual or special meeting of stockholders, provided that notice of such proposed alteration, amendment, repeal, recession or adoption is

given in the notice of such meeting.

CERTIFICATE OF ADOPTION OF BY-LAWS

Adoption by Incorporator

The undersigned person appointed in the Certificate of Incorporation to act as the Incorporator of SKECHERS, U.S.A., INC. hereby adopts the foregoing by-laws as the ByLaws of the corporation.

Executed this 28th day of May, 1998.

/s/ KASEY HANNAH

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Kasey Hannah, Incorporator

EXHIBIT 10.1

SKECHERS U.S.A., INC.

AMENDED AND RESTATED  
1998 STOCK OPTION, DEFERRED STOCK  
AND  
RESTRICTED STOCK PLAN

SECTION 1. GENERAL PURPOSE OF PLAN; DEFINITIONS.

(a) This plan is intended to implement and govern the 1998 Stock Option, Deferred Stock and Restricted Stock Plan (the "Plan") of Skechers U.S.A., Inc., a California corporation (the "Company"). The Plan was adopted by the Board of Directors as of January 15, 1998, subject to the approval of the Company's shareholders. The purpose of the Plan is to enable the Company and its Subsidiaries to obtain and retain competent personnel who will contribute to the Company's success by their ability, ingenuity and industry, and to provide incentives to such personnel and members that are linked directly to increases in shareholder value, and will therefore, inure to the benefit of all shareholders of the Company.

(b) For purposes of the Plan, the following terms shall be defined as set forth below:

(1) "Administrator" means the Board, or if the Board does not administer the Plan, the Committee in accordance with Section 2.

(2) "Award" means any award of Deferred Stock, Restricted Stock, or Stock Option.

(3) "Board" means the Board of Directors of the Company.

(4) "Code" means the Internal Revenue Code of 1986, as amended from time to time, or any successor thereto.

(5) "Committee" means the Compensation Committee of the Board, or any other Committee the Board may subsequently appoint to administer the Plan. If at any time the Board shall administer the Plan, then the functions of the Board specified in the Plan shall be exercised by the Committee.

(6) "Company" means Skechers U.S.A., Inc., a corporation organized under the laws of the State of California (or any successor corporation).

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(7) "Covered Security" means any security listed under Subsection (b) of Section 18 of the Securities Act of 1933, as amended, or defined as such pursuant to the Rules and Regulations of the SEC.

(8) "Deferred Stock" means an award made pursuant to Section 7 below of the right to receive Stock at the end of a specified deferral period.

(9) "Disability" means permanent and total disability as determined under the Company's disability program or policy.

(10) "Effective Date" shall mean the date provided pursuant to Section 18.

(11) "Eligible Employee" means an employee, officer, director, consultant or advisor of the Company, any Subsidiary or Parent Corporation eligible to participate in the Plan pursuant to Section 4;

(12) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(13) "Fair Market Value" means, as of any given date, with respect to any Awards granted hereunder, at the discretion of the Administrator and subject to such limitations as the Administrator may impose, (A) the closing sale price of the Stock on such date as reported in the Western Edition of the Wall Street Journal Composite Tape, or (B) the average of the closing price of the Stock on each day on which the Stock was traded over a period of up to twenty trading days immediately prior to such date, or (C) if the Stock is not publicly traded, the fair market value of the Stock as otherwise determined by the Administrator in the good faith exercise of its discretion.

(14) "Incentive Stock Option" means any Stock Option intended to be designated as an "Incentive Stock Option" within the meaning of Section 422 of the Code.

(15) "Non-Qualified Stock Option" means any Stock Option that is not an Incentive Stock Option, including any Stock Option that provides (as of the time such option is granted) that it will not be treated as an Incentive Stock Option.

(16) "Parent Corporation" means any corporation (other than the Company) in an unbroken chain of corporations ending with the Company, if each of the corporations other than the Company owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in the chain.

(17) "Participant" means any Eligible Employee selected by the Administrator pursuant to the Administrator's authority in Section 2 below, to receive grants of Stock Options or Awards or any combination of the foregoing.

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(18) "Restricted Period" means the period set by the Administrator as it pertains to Deferred Stock or Restricted Stock Awards pursuant to Section 7.

(19) "Restricted Stock" means an award of shares of Stock granted pursuant to Section 7 subject to restrictions that will lapse with the passage of time or upon the attainment of performance objectives.

(20) "Stock" means the Common Stock, no par value per share, of the Company.

(21) "SEC" means the Securities and Exchange Commission.

(22) "Stock Option" means an option to purchase shares of Stock granted pursuant to Section 5.

(23) "Subsidiary" means any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company, if each of the corporations (other than the last corporation) in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in the chain.

## SECTION 2. ADMINISTRATION.

(a) The Plan shall be administered by the Board or by a Committee appointed by the Board, which shall serve at the pleasure of the Board; provided, however, that if the Committee does not consist solely of "Non-Employee Directors," as defined in Rule 16b-3 as promulgated by the SEC under the Exchange Act, as such Rule may be amended from time to time, or any successor definition adopted by the Commission, then the Plan shall be administered, and each grant shall be approved, by the Board.

(b) The Administrator shall have the power and authority to grant to Eligible Employees, pursuant to the terms of the Plan: (A) Stock Options, (B) Deferred Stock, (C) Restricted Stock, or (D) any combination of the foregoing.

In particular, the Administrator shall have the authority;



(1) to select those employees of the Company or any Subsidiary or Parent Corporation who are Eligible Employees;

(2) to determine whether and to what extent Stock Options, Deferred Stock, Restricted Stock or a combination of the foregoing, are to be granted to Eligible Employees of the Company or any Subsidiary hereunder;

(3) to determine the number of shares of Stock to be covered by each such Award;

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(4) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any such Award including, but not limited to, (x) the restricted period applicable to Deferred Stock or Restricted Stock Awards, (y) the date or dates on which restrictions applicable to such Deferred Stock or Restricted Stock shall lapse during such period, and (z) when and in what increments shares covered by Stock Options may be purchased; and

(5) to determine the terms and conditions, not inconsistent with the terms of the Plan, which shall govern all written instruments evidencing the Stock Options, Deferred Stock, Restricted Stock or any combination of the foregoing.

(c) The Administrator shall have the authority, in its discretion, to adopt, alter and repeal such administrative rules, guidelines and practices governing the Plan as it shall from time to time deem advisable; to interpret the terms and provisions of the Plan and any Award issued under the Plan (and any agreements relating thereto); and to otherwise supervise the administration of the Plan.

(d) All decisions made by the Administrator pursuant to the provisions of the Plan shall be final and binding on all persons, including the Company, any Subsidiaries, Parent Corporation and the Participants.

### SECTION 3. STOCK SUBJECT TO PLAN.

(a) The total number of shares of Stock reserved and available for issuance under the Plan shall be three hundred seventy-five (375) shares. Such shares shall consist of authorized but unissued shares. Except in the event that the Stock is a Covered Security, at no time shall the total number of shares issuable upon exercise of all outstanding options and the total number of shares provided for under any stock bonus plan of the issuer exceed the applicable percentage as calculated in accordance with the conditions and exclusions of Section 260.140.45 of the California Corporate Securities Rules, or any successor thereto, based on the shares of the issuer which are outstanding at the time the calculation is made.

(b) To the extent that (i) a Stock Option expires or is otherwise terminated without being exercised or (ii) any shares of Stock subject to any Deferred Stock or Restricted Stock Award granted hereunder are forfeited, such shares shall again be available for issuance in connection with future Awards under the Plan. If any shares of Stock have been pledged as collateral for indebtedness incurred by a Participant in connection with the exercise of a Stock Option and such shares are returned to the Company in satisfaction of such indebtedness, such shares shall again be available for issuance in connection with future Awards under the Plan.

(c) In the event of any merger, reorganization, consolidation, recapitalization, stock dividend, or other change in corporate structure affecting the Stock, a substitution or adjustment may be made in (i) the aggregate number of shares reserved for issuance under the Plan, and (ii) the kind, number and option price of shares subject to outstanding Stock Options granted under the Plan as may be determined by the Administrator, in its sole discretion. Such other substitutions or

adjustments shall be made as may be determined by the Administrator, in its sole discretion; provided, however, that with respect to Incentive Stock Options, such adjustment shall be made in accordance with Section 424 of the Code.

#### SECTION 4. ELIGIBILITY.

Officers and other key employees, directors and consultants and advisors of the Company, any Subsidiary or Parent Corporation who are responsible for or contribute to the management, growth and/or profitability of the business of the Company, shall be eligible to be granted Non-Qualified Stock Options and Deferred Stock or Restricted Stock Awards hereunder. Officers and other key employees of the Company, any Subsidiary or Parent Corporation shall also be eligible to be granted Incentive Stock Options hereunder. The Participants under the Plan shall be selected from time to time by the Administrator, in its sole discretion, from among the Eligible Employees recommended by the senior management of the Company, and the Administrator shall determine, in its sole discretion, the number of shares covered by each Award.

#### SECTION 5. STOCK OPTIONS FOR ELIGIBLE EMPLOYEES.

(a) Stock Options may be granted to Eligible Employees alone or in addition to other Awards granted under the Plan. Any Stock Option granted under the Plan shall be in such form as the Administrator may from time to time approve, and the provisions of Stock Option awards need not be the same with respect to each optionee. Recipients of Stock Options shall enter into a stock option agreement with the Company, in such form as the Administrator shall determine, which agreement shall set forth, among other things, the exercise price, the term, and provisions regarding exercisability of the option granted thereunder.

The Stock Options granted under the Plan to Eligible Employees may be of two types: (x) Incentive Stock Options and (y) Non-Qualified Stock Options.

(b) The Administrator shall have the authority under this Section 5 to grant any optionee Incentive Stock Options, Non-Qualified Stock Options, or both types of options; provided, however, that Incentive Stock Options may not be granted to any individual who is not an employee of the Company, its Subsidiaries or Parent Corporation. To the extent that any Stock Option does not qualify as an Incentive Stock Option, it shall constitute a separate Non-Qualified Stock Option. More than one option may be granted to the same optionee and be outstanding concurrently hereunder.

(c) Stock Options granted under the Plan shall be subject to the following terms and conditions and shall contain such additional terms and conditions, not inconsistent with the terms of the Plan, as the Administrator shall deem desirable:

(i) Option Price. The option price per share of Stock purchasable under an Incentive Stock Option shall be determined by the Administrator in its sole discretion at the time of grant but shall be not less than 100% of the Fair Market Value of the Stock on such date, and shall not, in any

event, be less than the par value of the Stock. The option price per share of Stock purchasable under a Non-Qualified Stock Option may not be less than 85% of such Fair Market Value. If an employee owns or is deemed to own (by reason of the attribution rules applicable under Section 424(d) of the Code) more than 10% of the combined voting power of all classes of stock of the Company or any Parent Corporation or Subsidiary and an Incentive Stock Option is granted to such employee, the option price of such Incentive Stock Option (to the extent required by the Code at the time of grant) shall be no less than 110% of the

Fair Market Value of the Stock on the date such Incentive Stock Option is granted.

(ii) Option Term. The term of each Stock Option shall be fixed by the Administrator, but no Stock Option shall be exercisable more than ten years after the date such Stock Option is granted; provided, however, that if an employee owns or is deemed to own (by reason of the attribution rules of Section 424(d) of the Code) more than 10% of the combined voting power of all classes of stock of the Company or any Parent Corporation or Subsidiary and an Incentive Stock Option is granted to such employee, the term of such Incentive Stock Option (to the extent required by the Code at the time of grant) shall be no more than five years from the date of grant.

(iii) Exercisability. Stock Options shall be exercisable at such time or times and subject to such terms and conditions as shall be determined by the Administrator at or after grant; provided, however, that, except as provided herein or unless otherwise determined by the Administrator at or after grant, Stock Options shall be exercisable one year following the date of grant of the option, but in no case, less than six (6) months following the date of the grant of the option. To the extent not exercised, installments shall accumulate and be exercisable in whole or in part at any time after becoming exercisable but not later than the date the Stock Option expires. The Administrator may provide, in its discretion, that any Stock Option shall be exercisable only in installments, and the Administrator may waive such installment exercise provisions at any time in whole or in part based on such factors as the Administrator may determine in its sole discretion.

(iv) Method of Exercise. Subject to Section 5(c) above, Stock Options may be exercised in whole or in part at any time during the option period, by giving written notice of exercise to the Company specifying the number of shares to be purchased, accompanied by payment in full of the purchase price in cash or its equivalent, as determined by the Administrator. As determined by the Administrator, in its sole discretion, payment in whole or in part may also be made (A) in the form of unrestricted Stock already owned by the optionee, or, in the case of the exercise of a Non-Qualified Stock Option, Restricted Stock subject to an Award hereunder (based, in each case, on the Fair Market Value of the Stock on the date the option is exercised), (B) by cancellation of any indebtedness owed by the Company to the optionee, (C) by a full recourse promissory note executed by the optionee, (D) by requesting that the Company withhold whole shares of Common Stock then issuable upon exercise of the Stock Option (based on the Fair Market Value of the Stock on the date the option is exercised), (E) in the event that a registration statement on Form S-8 has been filed with the SEC registering the Stock underlying the options, by arrangement with a broker which is acceptable to the Administrator where payment of the option price is made pursuant to an irrevocable direction to the broker to deliver all or part of the proceeds from the sale of the shares underlying the option

to the Company, or (F) by any combination of the foregoing; provided, however, that in the case of an Incentive Stock Option, the right to make payment in the form of already owned shares may be authorized only at the time of grant. Any payment in the form of Stock already owned by the optionee may be effected by use of an attestation form approved by the Administrator. If payment of the option exercise price of a Non-Qualified Stock Option is made in whole or in part in the form of Restricted Stock, the shares received upon the exercise of such Stock Option (to the extent of the number of shares of Restricted Stock surrendered upon exercise of such Stock Option) shall be restricted in accordance with the original terms of the Restricted Stock Award in question, except that the Administrator may direct that such restrictions shall apply only to that number of shares equal to the number of shares surrendered upon the exercise of such option. An optionee shall generally have the rights to dividends and other rights of a shareholder with respect to shares subject to the option only after the optionee has given written notice of exercise, has paid in full for such shares, and, if requested, has given the representation described in paragraph (a) of Section 11.

(d) The Administrator may require the voluntary surrender of all or a portion of any Stock Option granted under the Plan as a condition precedent to a grant of a new Stock Option. Subject to the provisions of the Plan, such new Stock Option shall be exercisable at the price, during such period and on such other terms and conditions as are specified by the Administrator at the time the new Stock Option is granted; provided, however, that should the Administrator so require, the number of shares subject to such new Stock Option shall not be greater than the number of shares subject to the surrendered Stock Option. Upon their surrender, the Stock Options shall be canceled and the shares previously subject to such canceled Stock Options shall again be available for grants of Stock Options and other Awards hereunder.

(e) Loans. The Company may make loans available to Stock Option holders in connection with the exercise of outstanding options granted under the Plan, as the Administrator, in its discretion, may determine. Such loans shall (i) be evidenced by full recourse promissory notes entered into by the Stock Option holders in favor of the Company, (ii) be subject to the terms and conditions set forth in this Section 5(e) and such other terms and conditions, not inconsistent with the Plan, as the Administrator shall determine, (iii) bear interest, if any, at such rate as the Administrator shall determine and (iv) be subject to Board approval. In no event may the principal amount of any such loan exceed the sum of (x) the exercise price less the par value of the shares of Stock covered by the option, or portion thereof, exercised by the holder and (y) any Federal, state, and local income tax attributable to such exercise. The initial term of the loan, the schedule of payments of principal and interest under the loan and the conditions upon which the loan will become payable in the event of the holder's termination of employment shall be determined by the Administrator; provided, however, that the term of the loan, including extensions, shall not exceed seven years. Unless the Administrator determines otherwise, when a loan is made, shares of Common Stock having a Fair Market Value at least equal to the principal amount of the loan shall be pledged by the holder to the Company as security for payment of the unpaid balance of the loan, and such pledge shall be evidenced by a pledge agreement, the terms of which shall be determined by the Administrator, in its discretion; provided, however, that each loan shall comply with all applicable laws, regulations and rules of the Board of Governors of the Federal Reserve System and any other governmental agency having jurisdiction, and

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provided further that in the case of a loan to an Eligible Employee who is not an officer, director or employee of the Company, the loan shall be secured by adequate collateral other than the shares of Stock acquired.

(f) Limits on Transferability of Options. No Stock Option shall be transferable by the optionee otherwise than by will or by the laws of descent and distribution, and all Stock Options shall be exercisable, during the optionee's lifetime, only by the optionee.

(g) Termination by Death. If an optionee's employment with the Company, any Subsidiary or Parent Corporation terminates by reason of death, the Stock Option may thereafter be immediately exercised, to the extent then exercisable (or on such accelerated basis as the Administrator shall determine at or after grant), by the legal representative of the estate or by the legatee of the optionee under the will of the optionee, for a period of twelve months (or such shorter period as the Administrator shall specify at grant, but in no event less than six months) from the date of such death.

(h) Termination by Reason of Disability. If an optionee's employment with the Company, any Subsidiary or Parent Corporation terminates by reason of Disability, any Stock Option held by such optionee may thereafter be exercised, to the extent it was exercisable at the time of such termination (or on such accelerated basis as the Administrator shall determine at the time of grant), for a period of twelve months (or such shorter period as the Administrator shall specify at grant, but in no event less than six months) from the date of such termination of employment. In the event of a termination of employment by reason of Disability, if an Incentive Stock Option is exercised after the expiration of the exercise periods that apply for purposes of Section 422 of the Code, such Stock Option shall thereafter be treated as a Non-Qualified Stock Option.

(i) Other Termination. Except as otherwise provided in this paragraph or otherwise determined by the Administrator, if an optionee's employment with the Company, any Subsidiary or Parent Corporation terminates for any reason other than death or Disability, any accrued Stock Option may be exercised until the earlier to occur of (i) three months from the date of such termination or (ii) the expiration of the stated term of such Stock Option; provided, however, that if the expiration of the stated term of such Stock Option is less than 30 days from the date of termination, then such Stock Option shall expire 30 days from the date of termination.

(j) Annual Limit on Incentive Stock Options. To the extent that the aggregate Fair Market Value (determined as of the date the Incentive Stock Option is granted) of the shares of Stock with respect to which Incentive Stock Options granted to an optionee under this Plan and all other option plans of the Company, its Parent Corporation and any Subsidiary become exercisable for the first time by the optionee during any calendar year exceeds \$100,000, such Stock Options shall be treated as Non-Qualified Stock Options.

SECTION 6. Intentionally omitted.

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#### SECTION 7. DEFERRED STOCK AND RESTRICTED STOCK.

(a) General. Deferred Stock and Restricted Stock awards may be issued to Eligible Employees either alone or in addition to other Awards granted under the Plan. The Administrator shall determine the Eligible Employees, and the time or times at which, grants of Deferred Stock or Restricted Stock awards shall be made; the number of shares to be awarded; the price, if any, to be paid by the recipient of Deferred Stock or Restricted Stock awards; the Restricted Period (as defined in paragraph 7(c) hereof) applicable to Deferred Stock or Restricted Stock awards; the performance objectives applicable to Deferred Stock or Restricted Stock awards; the date or dates on which restrictions applicable to such Deferred Stock or Restricted Stock awards shall lapse during such Restricted Period; and all other conditions of the Deferred Stock or Restricted Stock awards. The Administrator may also condition the grant of Deferred Stock or Restricted Stock awards upon the exercise of Stock Options, or upon such other criteria as the Administrator may determine, in its sole discretion. The provisions of Deferred Stock or Restricted Stock awards need not be the same with respect to each recipient.

(b) Awards and Certificates. The prospective recipient of a Deferred Stock or Restricted Stock award shall not have any rights with respect to such Award, unless and until such recipient has executed an agreement evidencing the Award (a "Deferred Stock Award Agreement" or Restricted Stock Award Agreement" as appropriate) and has delivered a fully executed copy thereof to the Company, within a period of sixty days (or such other period as the Administrator may specify) after the Award date.

Except as provided below in this Section 7(b), (i) each Participant who is awarded Restricted Stock shall be issued a stock certificate in respect of such shares of Restricted Stock; and (ii) such certificate shall be registered in the name of the Participant, and shall bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Award, substantially in the following form:

"The transferability of this certificate and the shares of stock represented hereby are subject to the terms and conditions (including forfeiture) of the Skechers U.S.A., Inc., 1998 Stock Option, Deferred Stock and Restricted Stock Plan and a Restricted Stock Award Agreement entered into between the registered owner and Skechers U.S.A., Inc. Copies of such Plan and Agreement are on file in the offices of Skechers U.S.A., Inc."

The Company shall require that the stock certificates evidencing such shares be held in the custody of the Company until the restrictions thereon shall have lapsed, and that, as a condition of any Restricted Stock award, the

Participant shall have delivered a stock power, endorsed in blank, relating to the Stock covered by such Award.

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With respect to Deferred Stock awards, at the expiration of the Restricted Period, stock certificates in respect of such shares of Deferred Stock shall be delivered to the Participant, or his legal representative, in a number equal to the shares of Stock covered by the Deferred Stock award.

(c) Restriction and Conditions. The Deferred Stock or Restricted Stock awards granted pursuant to this Section 7 shall be subject to the following restrictions and conditions:

(i) Subject to the provisions of the Plan and the Deferred Stock or Restricted Stock Award Agreements, during such period as may be set by the Administrator commencing on the grant date (the "Restricted Period"), the Participant shall not be permitted to sell, transfer, pledge or assign shares of Deferred Stock or Restricted Stock awarded under the Plan. Within these limits, the Administrator may, in its sole discretion, provide for the lapse of such restrictions in installments and may accelerate or waive such restrictions in whole or in part based on such factors and such circumstances as the Administrator may determine, in its sole discretion, including, but not limited to, the attainment of certain performance related goals, the Participant's termination, death or Disability or the occurrence of a "Change of Control" as defined in Section 10 below.

(ii) Except as provided in paragraph (c)(i) of this Section 7, the Participant shall have, with respect to the shares of Restricted Stock, all of the rights of a shareholder of the Company, including the right to vote the shares, and the right to receive any dividends thereon during the Restricted Period. With respect to Deferred Stock awards, the Participant shall generally not have the rights of a shareholder of the Company, including the right to vote the shares during the Restricted Period; provided, however, that dividends declared during the Restricted Period with respect to the number of shares covered by a Deferred Stock award shall be paid to the Participant. Certificates for shares of unrestricted Stock shall be delivered to the Participant promptly after, and only after, the Restricted Period shall expire without forfeiture in respect of such shares of Deferred Stock or Restricted Stock, except as the Administrator, in its sole discretion, shall otherwise determine.

(iii) Subject to the provisions of the Deferred Stock or Restricted Stock Award Agreement and this Section 7, upon termination of employment for any reason during the Restricted Period, all shares subject to any restriction as of the date of such termination shall be forfeited by the Participant, and the Participant shall only receive the amount, if any, paid by the Participant for such Deferred Stock or Restricted Stock, plus simple interest on such amount at the rate of 8% per year.

#### SECTION 8. AMENDMENT AND TERMINATION.

(a) The Board may amend, alter or discontinue the Plan, but no amendment, alteration, or discontinuation shall be made that would impair the rights of the Participant under any Award theretofore granted without such Participant's consent, or that without the approval of the shareholders (as described below) would:

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(i) except as provided in Section 3, increase the total number of shares of Stock reserved for the purpose of the Plan;

(ii) change the employees or class of employees eligible to participate in the Plan;

(iii) extend the maximum option period under Section 5 of the Plan.

(b) Notwithstanding the foregoing, shareholder approval under this Section 8 shall only be required at such time and under such circumstances as shareholder approval would be required under applicable laws, regulations and exchange requirements.

(c) The Administrator may amend the terms of any Award theretofore granted, prospectively or retroactively, but, subject to Section 3, no such amendment shall impair the rights of any holder without his or her consent.

#### SECTION 9. UNFUNDED STATUS OF PLAN.

The Plan is intended to constitute an "unfunded" plan for incentive compensation. With respect to any payments not yet made to a Participant or optionee by the Company, nothing contained herein shall give any such Participant or optionee any rights that are greater than those of a general creditor of the Company.

#### SECTION 10. CHANGE OF CONTROL.

The following acceleration and valuation provisions shall apply in the event of a "Change of Control", as defined in paragraph (b) of this Section 10:

(a) In the event of a "Change of Control," unless otherwise determined by the Administrator or the Board in writing at or after grant (including under any individual agreement), but prior to the occurrence of such Change of Control;

(i) any Stock Options awarded under the Plan not previously exercisable and vested shall become fully exercisable and vested;

(ii) the restrictions applicable to any Restricted Stock or Deferred Stock awards under the Plan shall lapse, and such shares and Awards shall be deemed fully vested;

(iii) any indebtedness incurred pursuant to Section 5(e) above shall be forgiven and the collateral pledged in connection with any such loan shall be released; and

(iv) the value of all outstanding Stock Options, Restricted Stock and Deferred Stock awards shall, to the extent determined by the Administrator at or after grant, be cashed out by a payment of cash or other property, as the Administrator may determine, on the basis of the "Change

of Control Price" (as defined in paragraph (c) of this Section 10) as of the date the Change of Control occurs or such other date as the Administrator may determine prior to the Change of Control.

(b) For purposes of paragraph (a) of this Section 10, a "Change of Control" shall be deemed to have occurred if:

(i) any "person," as such term is used in Sections 13(d) and 14(d) of the Exchange Act (other than the Company; any trustee or other fiduciary holding securities under an employee benefit plan of the Company; or any company owned, directly or indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of the Stock of the Company) is or becomes after the Effective Date the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company (not including in the securities beneficially owned by such person or any securities acquired directly from the Company or its

affiliates) representing 30% or more of the combined voting power of the Company's then outstanding securities; or

(ii) during any period of two consecutive years (not including any period prior to the Effective Date), individuals who at the beginning of such period constitute the Board, and any new director (other than a director designated by a person who has entered into an agreement with the Company to effect a transaction described in clause (i), (iii) or (iv) of this Section 10(b)) whose election by the Board or nomination for election by the Company's shareholders was approved by a vote of at least two-thirds (2/3) of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute at least a majority thereof; or

(iii) the shareholders of the Company approve a merger or consolidation of the Company with any other corporation, other than (A) a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity), in combination with the ownership of any trustee or other fiduciary holding securities under an employee benefit plan of the Company, at least 75% of the combined voting power of the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation or (B) a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no person acquires more than 50% of the combined voting power of the Company's then outstanding securities; or

(iv) the shareholders of the Company approve a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets.

(c) For purposes of this Section 10, "Change of Control Price" means the higher of (i) the highest price per share paid or offered in any transaction related to a Change of Control of the Company or (ii) the highest price per share paid in any transaction reported on the exchange or

national market system on which the Stock is listed, at any time during the preceding sixty day period as determined by the Administrator, except that, in the case of Incentive Stock Options, such price shall be based only on transactions reported for the date on which the Administrator decides to cash out such options.

#### SECTION 11. GENERAL PROVISIONS.

(a) The Administrator may require each person purchasing shares pursuant to a Stock Option to represent to and agree with the Company in writing that such person is acquiring the shares without a view to distribution thereof. The certificates for such shares may include any legend which the Administrator deems appropriate to reflect any restrictions on transfer.

All certificates for shares of Stock delivered under the Plan shall be subject to such stock-transfer orders and other restrictions as the Administrator may deem advisable under the rules, regulations, and other requirements of the Commission, any stock exchange upon which the Stock is then listed, and any applicable Federal or state securities law, and the Administrator may cause a legend or legends to be placed on any such certificates to make appropriate reference to such restrictions.

(b) Nothing contained in the Plan shall prevent the Board from adopting other or additional compensation arrangements, subject to shareholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases.

(c) Each Participant shall, no later than the date as of which the value of an Award first becomes includable in the gross income of the Participant for



Federal income tax purposes, pay to the Company, or make arrangements satisfactory to the Administrator regarding payment of, any Federal, state, or local taxes of any kind required by law to be withheld with respect to the Award. The obligations of the Company under the Plan shall be conditional on the making of such payments or arrangements, and the Company (and, where applicable, its Subsidiaries) shall, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to the Participant.

(d) No member of the Board or the Administrator, nor any officer or employee of the Company acting on behalf of the Board or the Administrator, shall be personally liable for any action, determination, or interpretation taken or made in good faith with respect to the Plan, and all members of the Board or the Administrator and each and any officer or employee of the Company acting on their behalf shall, to the extent permitted by law, be fully indemnified and protected by the Company in respect of any such action, determination or interpretation.

(e) This Plan is purely voluntary on the part of the Company, and while the Company hopes to continue it indefinitely, the continuance of the Plan shall not be deemed to constitute a contract between the Company and any employee, or to be consideration for or a condition of the employment of any employee. Nothing contained in the Plan shall be deemed to give any employee

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the right to be retained in the employ of the Company, its Subsidiaries, or its Parent Corporation to interfere with the right of the Company, or its Subsidiaries to discharge or retire any employee thereof at any time. No employee shall have any right to, or interest in, Stock Options, Restricted Stock, or Deferred Stock, authorized hereunder prior to the grant of such a Stock Option or other award described herein to such employee, and upon such grant he or she shall have only such rights and interests as are expressly provided herein, subject, however, to all applicable provisions of the Company's Articles of Incorporation, as the same may be amended from time to time.

#### SECTION 12. SPECIFIC PERFORMANCE.

The Stock Options granted under this Plan and the Shares issued pursuant to the exercise of such Stock Options cannot be readily purchased or sold in the open market, and, for that reason among others, the Company and its shareholders will be irreparably damaged in the event that this Plan is not specifically enforced. In the event of any controversy concerning the right or obligation to purchase or sell any such Option or Optioned Stock, such right or obligation shall be enforceable in a court of equity by a decree of a specific performance. Such remedy shall, however, be cumulative and not exclusive, and shall be in addition to any other remedy which the parties may have.

#### SECTION 13. INVALID PROVISION.

In the event that any provision of this Plan is found to be invalid or otherwise unenforceable under any applicable law, such invalidity or unenforceability shall not be construed as rendering any other provisions contained herein invalid or unenforceable, and all such other provisions shall be given full force and effect to the same extent as though the invalid unenforceable provision was not contained herein.

#### SECTION 14. APPLICABLE LAW.

This Plan shall be governed by and construed in accordance with the laws of the State of California.

#### SECTION 15. SUCCESSORS AND ASSIGNS.

This Plan shall be binding on and inure to the benefit of the Company and the employees to whom an Option is granted hereunder, and such employees' heirs, executors, administrators, legatees, personal representatives, assignees

and transferees.

SECTION 16. AUTHORIZATION TO ISSUE OPTIONS AND SHAREHOLDER APPROVAL.

Unless in the judgment of counsel to the Company such permit is not necessary with respect to particular grants, Stock Options granted under the Plan shall be conditioned upon the Company obtaining any required permit from the California Department of Corporations and/or other appropriate governmental agencies, free of any conditions not acceptable to the Board, authorizing

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the Company to grant such Stock Options, provided, however, such condition shall lapse as of the effective date of issuance of such permit(s) in a form to which the Company does not object within sixty (60) days. The grant of Stock Options under the Plan also is conditioned on approval of the Plan by the vote or consent of the holders of a majority of the outstanding shares of the Company's Common Stock and no Stock Option granted hereunder shall be effective or exercisable unless and until the Plan has been so approved within 12 months of the adoption of the Plan.

SECTION 17. ANNUAL REPORT.

Except at such time as the Stock becomes a Covered Security, if any consultants or directors are issued Stock Options under this Plan, the Company shall furnish such consultants or directors with financial statements at least annually.

SECTION 18. EFFECTIVE DATE OF PLAN.

The Plan became effective (the "Effective Date") on January 15, 1998.

SECTION 19. TERM OF PLAN.

No Stock Option, Deferred Stock or Restricted Stock award shall be granted pursuant to the Plan on or after the tenth anniversary of the Effective Date, but Awards theretofore granted may extend beyond that date.

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IN WITNESS WHEREOF, pursuant to the due authorization and adoption of this Plan by the Board on the day and year first above written, the Company has caused this Plan to be duly executed by its duly authorized officers.

SKECHERS U.S.A., INC.

By: /s/ DAVID WEINBERG

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Name: David Weinberg  
Title: Chief Financial Officer

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EXHIBIT 10.12

COMMERCIAL LEASE AGREEMENT

SKETCHERS INC  
TENANT

PRESENTED BY:

RICHARD & DONNA PIAZZA  
February 19, 1997

PROPERTY LOCATION

1110 MANHATTAN AVE  
MANHATTAN BEACH, CA.

COMMERCIAL LEASE

THIS LEASE is entered into between RICHARD AND DONNA PIAZZA, (hereinafter referred to as "LANDLORD") and SKETCHERS INC., (hereinafter referred to as "TENANT").

NOW THEREFORE, in consideration of the mutual promises and agreements herein contained, the parties thereto agree as follows:

ARTICLE I

Premises

1.10 LANDLORD hereby leases the TENANT, and TENANT hereby hires from LANDLORD, for the term, at the rental and upon the conditions hereafter set forth, those certain premises, (hereinafter referred to as the "PREMISES") known as 1110 Manhattan Ave., Manhattan Beach, California, and described as set forth on the plat map attached hereto and incorporated herein by reference as Exhibit "A" consisting of approximately 4800, square feet of space.

1.02 LANDLORD covenants, agrees and warrants that as long as TENANT is not in default under the terms of this Lease, TENANT shall have quiet and peaceful possession of the premises and shall enjoy all the rights herein granted without interference.

1.03 LANDLORD may subordinate this Lease to any Lender so long as Lender agrees that as long as TENANT performs his obligations thereunder, nothing shall affect TENANT'S Lease.

1.04 LANDLORD and TENANT mutually agree that this lease agreement supersedes all previous lease agreements for any premises that may be or have been owned by LANDLORD.

ARTICLE II

Term

2.01 The term of this Lease shall commence on March 1, 1997, and continue until February 28, 2002.

2.02 TENANT shall be allowed to move into the premises anytime after the signing of this lease on condition that all certificates of insurance as requires herein are delivered to LANDLORD prior to

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the date of his taking possession of the premises and his payment of the first months rent and the security deposit as provided herein.

2.03 TENANT shall have TWO (2) option to extend the term on this Lease. Said options shall have the same terms and conditions and covenants contained herein except for the rental rate, which shall be as set forth in 3.03. The options shall be for the period commencing March 1, 2002 and ending February 28, 2007, and the second option shall begin on March 1, 2007 and end on February 28, 2012.

2.04 TENANT may exercise the options by giving to LANDLORD written notice at least three (3) months prior to, but not more than six (6) months prior to the expiration of the original term of this Lease or the term of the option period.

### ARTICLE III

#### Fixed Rent

3.01 TENANT agrees to pay to LANDLORD, in addition to the sums specified in Section 3.02 of this Lease, a fixed rental for the use and occupancy of said Premises of Eighty Eight Hundred (\$8,800.00) Dollars per month, payable on the first (1st) day of each and every month commencing on March 1, 1997, and continuing for the remaining term of the lease and the option period except as otherwise provided therein

3.02 In addition to the rent stated herein, TENANT shall pay to LANDLORD when billed, all pro-rata share of property taxes and assessments levied during the term of this lease together with all prorata share of insurance premiums for Insurance Coverage on the premises. If Tenant fails to pay such taxes, assessments for any such late payments when such payments are due. If LANDLORD is obligated to make any such payments, TENANT shall pay to LANDLORD an additional sum of Ten (10) percent of such payment as a service charge to landlord for his handling of the payment of these obligations.

3.03 On March 1, 1998, of lease, the monthly rental shall be adjusted by four (4.0%) percent over the rental rate for the previous year of the lease term. i.e. The rent for March 1, 1998 shall be Nine Thousand One hundred and Fifty Two (\$9,152.00) dollars, and each year thereafter, for the term of this lease, the rent shall be increased by four (4.0%) percent.

3.4 TENANT in addition to the rent due for the month of March 1, 1997, TENANT, upon the

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signing of this lease, shall deposit with LANDLORD the sum of Eighty Eight Hundred (\$8,800.00) Dollars, which deposit shall be considered a security deposit.

### ARTICLE IV

#### Takes and Utilities

4.01 TENANT shall pay all taxes and assessments levied against any personal property or trade fixtures belonging to TENANT and or LANDLORD and used on the premises.

4.02 TENANT shall pay all utilities or services, including water, power and gas and trash collection used by TENANT for the operation of his business on the premises, including the payment of janitorial services for the cleaning of the premises and shall keep all trash contained in an area so designated by LANDLORD.

## ARTICLE V

### Alterations and Repairs

5.01 TENANT shall not make any structural or exterior alterations to the premises with LANDLORD'S consent. TENANT at his cost and expense shall have the right to make, with LANDLORD'S consent, non-structural alterations to the interior of the premises of the building as are required in order for TENANT to conduct his business on the premises. All alterations shall be completed with due diligence in compliance with applicable laws.

5.02 TENANT shall not be allowed to remove any alteration which he has made to the property.

5.02(a) TENANT shall pay for all costs of construction performed by it or caused to be performed by it on the Premises. TENANT shall keep the premises free and clear of all mechanic's liens resulting from construction performed by / or for TENANT.

5.02 (b) TENANT shall have the right to contest the correctness or the validity of any such lien, if immediately on demand of LANDLORD, TENANT procures and records a lien release bond issued by a corporation authorized to issue bonds in the state of California, equal to one-half of the amount of the claim of the lien.

5.03 LANDLORD shall maintain at its cost all structural parts of the building together with the roof.

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5.04 TENANT shall maintain at its own cost and expense the following:

- (a) window frames;
- (b) all interior portions of the demised premises;
- (c) all plumbing, sewage systems problems and electrical problems within the demised premises;
- (d) all portions of the building for damage caused by the acts or omissions of TENANT or its authorized agents or representatives;
- (e) the heating and air conditioning systems;
- (f) the plate glass;
- (g) all other aspects of the building except for those portions of the building set forth in Section 5.03 of this lease;

5.05 If so required, TENANT may install and maintain its own alarm system at its own cost and expense.

## ARTICLE VI

### Destruction and Condemnation

6.01 If the premises or the building in which the premises are located shall be destroyed by fire or other causes, or be so damaged thereby that the premises are untenable and cannot be rendered tenantable within ninety (90) days from the date of such destruction or damage, the Lease may be terminated by LANDLORD by written notice. In case the damage or destruction is not such as to allow a termination of the Lease as above provided, then a proportionate reduction shall be made in the rent corresponding to the time during which TENANT shall be deprived of possession.

6.02 If the whole or any part of the premises shall be taken or condemned by any competent authority under power of eminent domain, then at LANDLORD'S option to be exercised by written notice such taking, and without an apportionment of the award. TENANT hereby assigns to LANDLORD all rights and claims to the award for the property and building. TENANT may pursue Any and all

rights against such competent authority for any damages caused to its business interest. Nothing in this paragraph shall allow TENANT to interfere with LANDLORDS right to effect a settlement of its

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claims or reduce the amount that LANDLORD shall be entitled to pursuant to any such taking. The current rent, however, in such case shall be reduced by an amount that is in the same ratio as the value of the area of the portion of the premises bears to the total value of the premises immediately before the date of taking. If such reduction exceeds 25% of the lease property, TENANT shall have the right to terminate this lease.

6.03 If the whole or any part of the premises shall be ordered to be repaired, to comply with any building and safety requirements or ordinances or earthquake ordinances during the term of this lease, LANDLORD shall have the option to terminate the lease if he shall be required to have the property vacated to complete the repairs of the premises by giving TENANT one hundred twenty (120) days written notice of his intent to terminate. LANDLORD'S Notice of termination shall include written proof of the necessity to complete the required repairs. Such proof shall be from a contractor setting forth the nature of the changes and the Department of Building and Safety's requirement to complete such repairs.

## ARTICLE VII

### Indemnity and Insurance

7.01 TENANT agrees to hold LANDLORD free and harmless and defend LANDLORD against any and all claims or liability for any injury or damage to any person or property occurred in, on, or about the premises, except that LANDLORD shall be liable to TENANT for damages resulting from the acts or omissions of LANDLORD or its authorized representatives. A party's obligation under this section to indemnify and hold the other party free and harmless shall be limited to the sum that exceeds the amount of insurance proceeds, if any received by the party being indemnified.

7.02 TENANT, at its cost and expense, shall maintain public liability insurance and property damage insurance with limits of liability of not less than Five Hundred Thousand Dollars (\$500,000) per person and one Million Dollars (\$1,000,000) per occurrence, and property damage limits of not less than Three Hundred Thousand Dollars (\$300,000) per occurrence, insuring against all liability of TENANT and its authorized representatives arising out of and in connection with TENANT'S use or occupancy of the premises.

7.04 LANDLORD shall be named as an additional insured on all policies of insurance and

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certificates of insurance shall be delivered to THE LANDLORD immediately upon the issuance of the insurance and upon any renewal for the term of the lease.

## ARTICLE VIII

### Assignment

8.01 TENANT shall not voluntarily assigns or encumber its interest in this Lease or in the premises, or sublease all and any part of the premises without first obtaining the LANDLORD'S written consent, which consent shall not be unreasonably withheld. Any assignment, encumbrance or sublease without LANDLORD'S consent shall be voidable.

8.02 No interest of TENANT in this Lease shall be assignable by operation of law. Each of the following acts shall be considered an involuntary assignment:

(1) If a TENANT becomes bankrupt or insolvent or makes an assignment for the benefit of the creditors;

(2) If a writ of attachment or execution is levied on this Lease;

(3) If any proceedings are instituted and a receiver is appointed with authority to take possession of the premises.

## ARTICLE IX

### Termination

9.01 Upon termination of this Lease, TENANT shall surrender to LANDLORD the premises in good condition except for ordinary wear and tear and except for alterations that TENANT has the right to remove under the provisions of the lease. Upon such termination, TENANT shall restore the Premises to a good condition except for ordinary wear and tear.

9.02 If the TENANT holds over, without exercising the option with LANDLORD'S consent after the termination of the term, or after the date of any notice given to TENANT by LANDLORD, such possession shall be on a month-to-month tenancy at a monthly rental rate of Ten Thousand (\$10,000.00) Dollars per month, terminate on thirty (30) days notice given at any time by LANDLORD. All provisions of this Lease, except the rental rate, term and the option, shall apply to the month-to-month tenancy and the option, shall apply to the month-to-month tenancy and rent shall be as set forth above.

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## ARTICLE X

### General Provisions

#### 10.01 Definitions:

(a) "Party" shall mean LANDLORD or TENANT:

(b) "Tenant's personal property" shall mean TENANT'S equipment, furniture and movable property placed in the premises by TENANT, including TENANT'S trade fixtures;

(c) "TERM" shall mean the period of time during which TENANT has a right to occupy the premises;

10.02 The enforceability, invalidity or illegality of any provisions contained in this Lease shall not render the other provisions unenforceable, invalid or illegal.

10.03 No failure by either party to insist upon the strict performance by the other of any covenants, agreements, terms or conditions of this Lease or to exercise any right or remedy consequent upon a breach thereof, shall constitute a waiver of any such breach or of such covenant, agreement, term or condition. No waiver of any breach shall affect or alter this Lease, but each and every covenant, condition, agreement and term of this Lease shall continue in full force and effect with respect to any other existing or subsequent breach.

10.04 Time is of the essence of each provision of this Lease.

10.05 Each and all of the covenants, conditions and restrictions in this Lease shall inure to the benefit of and shall be binding upon the heirs, executors, administrators and successors in interest of LANDLORD and subject to the restrictions of this Lease, the authorized assignees, transferee, subtenants, licensees and other successors in interest of TENANT.

10.06 In the event that either LANDLORD or TENANT shall bring any action or proceeding for damages for an alleged breach of any provision of this Lease, to recover rents, or to enforce, protect or establish any right or remedy of either party the prevailing party shall be entitled to recover as part of such action or proceeding reasonable attorney's fees and court costs.

10.07 All rent checks are to be made payable to Richard and Donna

Piazza and delivered to LANDLORD at LANDLORD'S address.

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10.08 All notices, demands or requests from one party to the other may be personally delivered or sent by mail, postage prepaid, certified or registered, to the address stated in this section, and shall have been deemed to have been given at the time of personal delivery or at the end of the fifth full day following the date of mailing.

Landlord's Address: Richard and Donna Piazza

2612 Pine Ave.

Manhattan Beach, Ca. 90266

Tenant's Address:

1110 Manhattan Ave.

Manhattan Beach, Ca. 90266

Each party shall have the right from time to time to designate a different address by notice given in conformity with this section.

10.10 This Lease contains all the agreements of the parties and cannot be amended or modified except by written agreement.

10.11 TENANT accepts the premises in its present condition, "as is" with the exception of the agreed repairs and alterations which shall be listed on the schedule, attached hereto and incorporated herein by reference.

10.12 The premise shall be used as a Office and for no other purpose with the written consent of the LANDLORD, which consent shall not be unreasonable withheld.

10.13 TENANT shall obtain all necessary licenses and permits necessary to carry on his business at the location.

10.14 TENANT shall not commit, or suffer to be committed, any waste upon the demised premises, or any public or private nuisance

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10. 15 The LANDLORD or its authorized representatives shall have the right to enter the premises at all reasonable times and at reasonable frequent intervals to:

- (a) Determine whether the premises are in good condition;
- (b) To show the premises to prospective buyers;
- (c) To conduct LANDLORD activities on the premises;

10.16 TENANT at his cost and expense shall be allowed to erect any sign agreeable with LANDLORD on the premises after having obtained the LANDLORD'S written consent to the erection of the said sign, which consent shall not unreasonable withholds. TENANT shall be able to place any signs on premises that are in conformity with other signs in the general area.

10. 17 TENANT shall be responsible for maintaining the premises as set forth herein and shall maintain the proper receptacles for trash pick up, which shall be stored in appropriate locations on the premises so designated by LANDLORD, all such trash services shall be at the TENANTS own cost and expense. TENANT shall comply with all health and safety codes and other rules and regulations pertaining to the maintenance of trash areas and the disposal of trash or other materials and food products and products. TENANT shall hold LANDLORD free and harmless from any liability for the disposal of any product or material used on the site.



10.18 Neither party shall record this Lease without the consent of the other.

ARTICLE XI

Miscellaneous

11.01 TENANT shall at TENANT'S own cost and expense comply with all statutes, ordinances, regulations, and requirements of all governmental entities, both federal, state, county, or municipal, relating to TENANT'S use and occupancy of said premises whether such statute, ordinance, regulation, and requirement be now in force or hereinafter enacted. The judgement of any Court of competent jurisdiction, or the admission by LANDLORD in a proceeding brought against TENANT by any governmental entity, that TENANT has violated any such statute, ordinance, regulation, or requirement shall be conclusive as between LANDLORD and TENANT and shall be grounds for termination of this Lease by LANDLORD.

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This Lease has been executed by TENANT on 2/28/97

TENANT

/s/ DAVID WEINBERG

DAVID WEINBERG

This lease has been executed by LANDLORD on

LANDLORD

/s/ RICHARD PIAZZA

Richard Piazza

/s/ DONNA PIAZZA

Donna Piazza

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STANDARD INDUSTRIAL/COMMERCIAL MULTI-TENANT LEASE - MODIFIED NET AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION

[LOGO]

1. BASIC PROVISIONS ("Basic Provisions").

1.1 PARTIES: This Lease ("Lease"), dated for reference purposes only, June 12, 1998, is made by and between Richard and Donna Piazza, Trustees of the Piazza Family Trust ("Lessor") and Skechers U.S.A., Inc. ("Lessee"), (collectively the "PARTIES," or individually a "PARTY").

1.2(a) PREMISES: That certain portion of the Building, including all improvements (herein or to be provided by Lessor under the terms of this Lease, commonly known by the street address of 1112 Manhattan Ave., located in the City of Manhattan Beach, County of Los Angeles, State of California, with zip code 90266, as outlined on Exhibit \_\_ attached hereto ("PREMISES"). The "Building" is that certain building containing the PREMISES and generally described as (describe briefly the nature of the Building):

1108-1112 Manhattan Avenue, Manhattan Beach

In addition to Lessee's rights to use and occupy the Premises as hereinafter specified, Lessee shall have non-exclusive rights to the Common Areas (as defined in Paragraph 2.7 below) as hereinafter specified, but shall not have any rights to the roof, exterior walls or utility raceways of the Building or to any other buildings in the Industrial Center. The Premises, the Building, the Common Areas, the land upon which they are located, along with all other buildings and improvements thereon, are herein collectively referred to as the "Industrial Center." (Also see Paragraph 2.)

1.2(b) PARKING: None unreserved vehicle parking spaces ("UNRESERVED PARKING SPACES"); and None reserved vehicle parking spaces ("RESERVED PARKING SPACES"). (Also see Paragraph 2.6.)

1.3 TERM: 3 years and 8 1/2 months ("ORIGINAL TERM" commencing June 15, 1998 ("COMMENCEMENT DATE") and ending February 28, 2002 ("EXPIRATION DATE"). (Also see Paragraph 3.) See Paragraph 49.

1.4 EARLY POSSESSION: None ("EARLY POSSESSION DATE"). (Also see Paragraphs 3.2 and 3.3.)

1.5 BASIC RENT: \$5,658,000 per month ("BASE RENT"), payable on the first day of each month commencing July 1, 1998 (Also see Paragraph 4.)

If this box is checked, this Lease provides for the Base Rent to be adjusted per Addendum 50, attached hereto. See Paragraph 50.

1.6(a) BASE RENT PAID UPON EXECUTION: \$8,487.00. Base Rent for the period. Commencement date through July 31, 1998. See Paragraph 15.

1.6(b) LESSEE'S SHARE OF COMMON AREA OPERATING EXPENSES: Twenty-one percent (21%) ("LESSEE'S SHARE") as determined by

prorata square footage of the Premises as compared to the total square footage of the Building or  other criteria as described in Addendum \_\_\_\_.

1.7 SECURITY DEPOSIT: \$5,658.00 ("SECURITY DEPOSIT"). (Also see Paragraph 5.)

1.8 PERMITTED USE: General office use and no other purpose ("PERMITTED USE") (Also see Paragraph 6.)

1.9 INSURING PARTY: Lessor is the "Insuring Party." (Also see Paragraph 8.)

1.10(a) REAL ESTATE BROKERS. The following real estate broker(s) (collectively, the "BROKERS") and brokerage relationships exist in this transaction and are consented to by the Parties (check applicable boxes):

N/A represents Lessor exclusively ("LESSOR'S BROKER");

N/A represents Lessee exclusively ("LESSEE'S BROKER"); or

N/A represents both Lessor and Lessee ("DUAL AGENCY"). (Also see Paragraph 15.)

1.10(b) PAYMENT TO BROKERS. Upon the execution of this Lease by both Parties, Lessor shall pay to said Broker(s) jointly, or in such separate shares as they may mutually designate in writing, a fee as set forth in a separate written agreement between Lessor and said Broker(s) (or in the event there is no separate written agreement between Lessor and said Broker(s), the sum of \$0) for brokerage services rendered by said Broker(s) in connection with this transaction.

1.11 GUARANTOR. The obligations of the Lessee under this Lease are to be guaranteed by NONE ("GUARANTOR"). (Also see Paragraph 37.)

1.12 ADDENDA AND EXHIBITS. Attached hereto is an Addendum or Addenda consisting of Paragraphs 49 through 60 and Exhibits \_\_\_\_ through \_\_\_\_, all of which constitute a part of this Lease.

## 2. PREMISES, PARKING AND COMMON AREAS.

2.1 LETTING. Lessor hereby leases to Lessee, and Lessee hereby leases from Lessor, the Premises, for the term, at the rental, and upon all of the terms, covenants and conditions set forth in this Lease. Unless otherwise provided herein, any statement of square footage set forth in this Lease, or that may have been used in calculating rental and/or Common Area Operating Expenses, is an approximation which Lessor and Lessee agree is reasonable and the rental and Lessee's Share (as defined in Paragraph 1.6(b)) based thereon is not subject to revision whether or not the actual square footage is more or less. See Paragraph 52.

### 2.2 CONDITION.

2.4 ACCEPTANCE OF PREMISES. Lessee hereby acknowledges: (a) (that it has been advised by the Broker(s) to satisfy itself with respect to the condition of the Premises (including but not limited to the electrical and fire sprinkler systems, security, environmental aspects, seismic and earthquake requirements, and compliance with the Americans with Disabilities Act and applicable zoning, municipal, county, state and federal laws, ordinances and regulations and any covenants or restrictions of record (collectively, "APPLICABLE LAWS") and the present and future suitability of the Premises for Lessee's intended use; (b) that Lessee has made such investigation as it deems necessary with reference to such matters, is satisfied with reference thereto, and assumes all responsibility therefore as the same relate to Lessee's occupancy of the Premises and/or the terms of this Lease; and (c) that neither Lessor, nor any of Lessor's agents, has made any oral or written representations or warranties with respect to said matters other than as set forth in this Lease.

2.5 LESSEE AS PRIOR OWNER/OCCUPANT. The warranties made by Lessor in this Paragraph 2 shall be of no force or effect if immediately prior to the date set forth in Paragraph 1.1 Lessee was the owner or occupant of the Premises. In such event, Lessee shall, at Lessee's sole cost and expense, correct any non-compliance of the Premises with said warranties.

2.7 COMMON AREAS - DEFINITION. The term "COMMON AREAS" is defined as all areas and facilities outside the Premises and within the exterior boundary line of the Industrial Center and interior utility raceways within the Premises that are provided and designated by the Lessor from time to time for the general non-exclusive use of Lessor, Lessee and other Lessees of the Industrial Center and their respective employees, suppliers, shippers, customers, contractors and invitees, including parking areas, loading and unloading areas, trash areas, roadways, sidewalks, walkways, parkways, driveways and landscaped areas.

2.8 COMMON AREAS - LESSEE'S RIGHTS. Lessor hereby grants to Lessee, for the benefit of Lessee and its employees, suppliers, shippers, contractors, customers and invitees, during the term of this Lease, the non-exclusive right to use, in common with others entitled to such use, the Common Areas as they exist from time to time, subject to any rights, powers, and privileges reserved by Lessor under the terms hereof or under the terms of any rules and regulations or restrictions governing the use of the Industrial Center. Under no circumstances shall the right herein granted to use the Common Areas be deemed to include the right to store any property, temporarily or permanently, in the Common Area. Any such storage shall be permitted only by the prior written consent of Lessor or Lessor's designated agent, which consent may be revoked at any time. In the event that any unauthorized storage shall occur then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove the property and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor.

2.9 COMMON AREAS - RULES AND REGULATIONS. Lessor or such other person(s) as Lessor may appoint shall have the exclusive control and management of the Common Areas and shall have the right, from time to time, to establish, modify, amend and enforce reasonable Rules and Regulations with respect thereto in accordance with Paragraph 40. Lessee agrees to abide by and conform to all such Rules and Regulations, and to cause its employees, suppliers, shippers, customers, contractors and invitees to so abide and conform. Lessor shall not be responsible to Lessee for the non-compliance with said rules and regulations by other lessees of the Industrial Center.

2.10 COMMON AREAS - CHANGES. Lessor shall have the right, in Lessor's sole discretion, from time to time:

(a) To make changes to the Common Areas, including, without limitation, changes in the location, size, shape and number of driveways, entrances, parking spaces, parking areas, loading and unloading areas, ingress, egress, direction of traffic, landscaped areas, walkways and utility raceways;

(b) To close temporarily any of the Common Areas for maintenance purposes so long as reasonable access to the Premises remains available;

(c) To designate other land outside the boundaries of the Industrial Center to be a part of the Common Areas;

(d) To add additional buildings and improvements to the Common Areas;

(e) To use the Common Areas while engaged in making additional improvements, repairs or alterations to the Industrial Center, or any portion thereof; and

(f) To do and perform such other acts and make such other changes in, to or with respect to the Common Areas and Industrial Center as Lessor may, in the exercise of sound business judgment, deem to be appropriate.

### 3. TERM.

3.1 TERM. The Commencement Date, Expiration Date and Original Term of this Lease are as specified in Paragraph 1.3.

### 4. RENT.

4.1 BASE RENT. Lessee shall pay Base Rent and other rent or charges, as the same may be adjusted from time to time, to Lessor in lawful money of the United States, without offset or deduction, on or before the day on which it is due under the terms of this Lease. Base Rent and all other rent and charges for any period during the term hereof which is for less than one full month shall be prorated based upon the actual number of days of the month involved. Payment of Base Rent and other charges shall be made to Lessor at its address stated herein or to such other persons or at such other addresses as Lessor may from time to time designate in writing to Lessee.

4.2 COMMON AREA OPERATING EXPENSES. Lessee shall pay to Lessor during the term hereof, in addition to the Base Rent, Lessee's Share (as specified in Paragraph 1.6(b)) of all Common Area Operating Expenses, as hereinafter defined, during each calendar year of the term of this Lease, in accordance with the following provisions:

(a) "COMMON AREA OPERATING EXPENSES" are defined, for purposes of this Lease, as all costs incurred by Lessor relating to the ownership and operation of the Industrial Center, including, but not limited to, the following:

(i) The operation, repair and maintenance, in neat, clean, good order and condition, of the following:

(aa) The Common Areas, including parking areas, loading and unloading areas, trash areas, roadways, sidewalks, walkways, parkways, driveways, landscaped areas, striping, bumpers, irrigation systems, Common Area lighting facilities, fences and gates, elevators and roof.

(bb) Exterior signs and tenant directories.

(cc) Fire detection and sprinkler systems.

(ii) The cost of water, gas, electricity and telephone to service the Common Areas.

(iii) Trash disposal, property management and security services and the costs of any environmental inspections.

(v) Real Property Taxes (as defined in Paragraph 10.2) to be paid by Lessor for the Building and the Common Areas under Paragraph 10 hereof.

(vi) The cost of the premiums for the insurance policies maintained by Lessor under Paragraph B hereof.

(vii) Any deductible portion of an insured loss concerning the Building or the Common Areas.

(viii) Any other services to be provided by Lessor that are stated elsewhere in this Lease to be a Common Area Operating Expense.

(b) Any Common Area Operating Expenses and Real Property Taxes that are specifically attributable to the Building or to any other building in the Industrial Center or to the operation, repair and maintenance thereof, shall be allocated entirely to the Building or to such other building. However, any Common Area Operating Expenses and Real Property Taxes that are not specifically attributable to the Building or to any other building or to the operation, repair and maintenance thereof, shall be equitably allocated by Lessor to all buildings in the Industrial Center.

(c) The inclusion of the improvements, facilities and services set forth in Subparagraph 4.2(a) shall not be deemed to impose an obligation upon Lessor to either have said improvements or facilities or to provide those services unless the Industrial Center already has the same, Lessor already provides the services, or Lessor has agreed elsewhere in this Lease to provide the same or some of them.

(d) Lessee's Share of Common Area Operating Expenses shall be payable by Lessee within ten (10) days after a reasonably detailed statement of actual expenses is presented to Lessee by Lessor. At Lessor's option, however, an amount may be estimated by Lessor from time to time of Lessee's Share of annual Common Area Operating Expenses and the same shall be payable monthly or quarterly, as Lessor shall designate, during each 12-month period of the Lease term, on the same day as the Base Rent is due hereunder. Lessor shall deliver to Lessee within sixty (60) days after the expiration of each calendar year a reasonably detailed statement showing Lessee's Share of the actual Common Area Operating Expenses incurred during the preceding year. If Lessee's payments under this Paragraph 4.2(d) during said preceding year exceed Lessee's Share as indicated on said statement, Lessee shall be credited the amount of such over-

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payment against Lessee's Share of Common Area Operating Expenses next becoming due. If Lessee's payment under this Paragraph 4.2(d) during said preceding year were less than Lessee's Share as indicated on said statement, Lessee shall pay to Lessor the amount of the deficiency within ten (10) days after delivery by Lessor to Lessee of said statement. See paragraphs 53 and 54.

5. SECURITY DEPOSIT. Lessee shall deposit with Lessor upon Lessee's execution hereof the Security Deposit set forth in Paragraph 1.7 as security for Lessee's faithful performance of Lessee's obligations under this Lease, if Lessee fails to pay Base Rent or other charges due hereunder, or otherwise Defaults under this Lease (as defined in Paragraph 13.1), Lessor may use, apply or retain all or any portion of said Security Deposit for the payment of any amount due Lessor or to reimburse or compensate Lessor for any liability, cost, expense, loss or damage (including attorneys' fees) which Lessor may suffer or incur by reason thereof. If Lessor uses or applies all or any portion of said Security Deposit, Lessee shall within ten (10) days after written request therefore deposit monies with Lessor sufficient to restore said Security Deposit to the full amount required by this Lease. Any time the Base Rent increases during the term of this Lease, Lessee shall, upon written request from Lessor, deposit additional monies with Lessor as an addition to the Security Deposit so that the total amount of the Security Deposit shall at all times bear the same proportion to the then current Base Rent as the initial Security Deposit bears to the initial Base Rent set forth in Paragraph 1.5. Lessor shall not be required to keep all or any part of the Security Deposit separate from its general accounts. Lessor shall, at the expiration or earlier termination of the term hereof and after Lessee has vacated the Premises, return to Lessee (or, at lessor's option, to the last assignee, if any, of Lessee's Interest herein), that portion of the Security Deposit not used or applied by Lessor. Unless otherwise expressly agreed in writing by Lessor, no part of the Security Deposit shall be considered to be held in trust, to bear interest or other increment for its use, or to be prepayment for any monies to be paid by Lessee under this Lease.

6. USE.

6.1 PERMITTED USE.

(a) Lessee shall use and occupy the Premises only for the Permitted Use set forth in Paragraph 1.8, and for no other purpose. Lessee shall not use or permit the use of the Premises in a manner that is unlawful, creates waste or a nuisance, or that disturbs owners and/or occupants of, or causes damage to the Premises or neighboring premises or properties.

## 6.2 HAZARDOUS SUBSTANCES.

(a) REPORTABLE USES REQUIRE CONSENT. The term "HAZARDOUS SUBSTANCE" as used in this Lease shall mean any product, substance, chemical, material or waste whose presence, nature, quantity and/or intensity of existence, use, manufacture, disposal, transportation, spill, release or effect, either by itself or in combination with other materials expected to be on the Premises, is either: (i) potentially injurious to the public health, safety or welfare, the environment, or the Premises; (ii) regulated or monitored by any governmental authority; or (iii) a basis for potential liability of Lessor to any governmental agency or third party under any applicable statute or common law theory. Hazardous Substance shall include, but not be limited to, hydrocarbons, petroleum, gasoline, crude oil or any products or by-products thereof. Lessee shall not engage in any activity in or about the Premises which constitutes a Reportable Use (as hereinafter defined) of Hazardous Substances without the express prior written consent of Lessor and compliance in a timely manner (at Lessee's sole cost and expense) with all Applicable Requirements (as defined in Paragraph 6.3). "REPORTABLE USE" shall mean (i) the installation or use of any above or below ground storage tank, (ii) the generation, possession, storage, use, transportation, or disposal of a Hazardous Substance that requires a permit from, or with respect to which a report, notice, registration or business plan is required to be filed with, any governmental authority, and (iii) the presence in, on or about the Premises of Hazardous Substance with respect to which any Applicable Laws require that a notice be given to persons entering or occupying the Premises or neighboring properties. Notwithstanding the foregoing, Lessee may, without Lessor's prior consent but upon notice to Lessor and in compliance with all Applicable Requirements, use any ordinary and customary materials reasonably required to be used by Lessee in the normal course of the Permitted Use, so long as such use is not a Reportable Use and does not expose the Premises or neighboring properties to any meaningful risk of contamination or damage or expose Lessor to any liability therefor. In addition, Lessor may (but without any obligation to do so) condition its consent to any Reportable Use of any Hazardous Substance by Lessee upon Lessee's giving Lessor such additional assurances as Lessor, in its reasonable discretion, deems necessary to protect itself, the public, the Premises and the environment against damage, contamination or injury and/or liability therefor, including but not limited to the installation (and, at Lessor's option, removal on or before Lease expiration or earlier termination) of reasonably necessary protective modifications to the Premises (such as concrete encasements) and/or the deposit of an additional Security Deposit under Paragraph 5 hereof.

(b) DUTY TO INFORM LESSOR. If Lessee knows, or has reasonable cause to believe, that a Hazardous Substance has come to be located in, on, under or about the Premises or the Building, other than as previously consented to by Lessor, Lessee shall immediately give Lessor written notice thereof, together with a copy of any statement, report, notice, registration, application, permit, business plan, license, claim, action, or proceeding given to, or received from, any governmental authority or private party concerning the presence, spill, release, discharge of, or exposure to, such Hazardous Substance including but not limited to all such documents as may be involved in any Reportable Use involving the Premises. Lessee shall not cause or permit any Hazardous Substance to be spilled or released in, on, under or about the Premises (including, without limitation, through the plumbing or sanitary sewer system).

(c) INDEMNIFICATION. Lessee shall indemnify, protect, defend and hold Lessor, its agents, employees, lender and ground Lessor, if any, and the Premises, harmless from and against any and all damages, liabilities, judgments, costs, claims, liens, expenses, penalties, loss of permits and attorneys and consultants' fees arising out of or involving any Hazardous Substance brought onto the Premises by or for Lessee or by anyone under Lessee's control. Lessee's obligations under this Paragraph 6.2(c) shall include, but not be limited to, the effects of any contamination or injury to person, property or the environment created or suffered by Lessee, and the cost of investigation (including consultants' and attorneys' fees and testing), removal, remediation, restoration and/or abatement thereof, or of any contamination therein involved, and shall survive the expiration or earlier termination of this Lease. No

termination, cancellation or release agreement entered into by Lessor and Lessee from its obligations under this Lease with respect to Hazardous Substances, unless specifically as agreed by Lessor in writing at the time of such agreement.

6.3 LESSEE'S COMPLIANCE WITH REQUIREMENTS. Lessee shall, at Lessee's sole cost and expense, fully, diligently and in a timely manner, comply with all "APPLICABLE REQUIREMENTS," which term is used in this Lease to mean all laws, rules, regulations, ordinances, directives, covenants, easements and restrictions of record, permits, the requirements of any applicable fire insurance underwriter or rating bureau, and the recommendations of Lessor's engineers and/or consultants, relating in any manner to the Premises (including but not limited to matters pertaining to (i) industrial hygiene, (ii) environmental conditions, on, in, under or about the Premises, including soil and groundwater conditions, and (iii) the use, generation, manufacture, production, installation, maintenance, removal, transportation, storage, spill, or release of any Hazardous Substance), now in effect or which may hereafter come into effect Lessee shall, within five (5) days after receipt of Lessor's written request, provide Lessor with copies of all documents and information, including but not limited to permits, registrations, manifests, applications, reports and certificates, evidencing Lessee's compliance with any Applicable Requirements specified by Lessor, and shall immediately upon receipt notify Lessor in writing (with copies of any documents involved) of any threatened or actual claim, notice, citation, warning, complaint or report pertaining to or involving failure by Lessee or the Premises to comply with any Applicable Requirements.

6.4 INSPECTION; COMPLIANCE WITH LAW. Lessor, Lessor's agents, employees, contractors and designated representatives, and the holders of any mortgages, deeds of trust or ground leases on the Premises ("LENDERS") shall have the right to enter the Premises at any time in the case of an emergency, and otherwise at reasonable times, for the purpose of inspecting the condition of the Premises and for verifying compliance by Lessee with this Lease and all Applicable Requirements (as defined in Paragraph 6.3), and Lessor shall be entitled to employ experts and/or consultants in connection therewith to advise Lessor with respect to Lessee's activities, including but not limited to Lessee's installation, operation, use, monitoring, maintenance, or removal of any Hazardous Substance on or from the Premises. The costs and expenses of any such inspections shall be paid by the party requesting same, unless a Default or Breach of this Lease by Lessee or a violation of Applicable Requirements or a contamination, caused or materially contributed to by Lessee, is found to exist or to be imminent, or unless the inspection is requested or ordered by a governmental authority as the result of any such existing or imminent violation or contamination. In such case, Lessee shall upon request reimburse Lessor or Lessor's Lender, as the case may be, for the costs and expenses of such inspection.

## 7. MAINTENANCE, REPAIRS, UTILITY INSTALLATIONS, TRADE FIXTURES AND ALTERATIONS.

### 7.1 LESSEE'S OBLIGATIONS.

(a) Subject to the provisions of Paragraphs 7.2 (Lessor's Obligations), 9 (Damage or Destruction), and 14 (Condemnation), Lessee shall, at Lessee's sole cost and expense and at all times, keep the Premises and every part thereof in good order, condition and repair (whether or not such portion of the Premises requiring repair, or the means of repairing the same, are reasonably or readily accessible to Lessee, and whether or not the need for such repairs occurs as a result of Lessee's use, any prior use, the elements or the age of such portion of the Premises), including, without limiting the generality of the foregoing, all equipment or facilities specifically serving the Premises, such as plumbing, heating, air conditioning, ventilating, electrical, lighting facilities, boilers, fired or unfired pressure vessels, fire hose connections if within the Premises, fixtures, interior walls, interior surfaces of exterior walls, ceilings, floors, windows, doors, plate glass, and skylights, but excluding any items which are the responsibility of Lessor pursuant to Paragraph 7.2 below, Lessee in keeping the Premises in good order, condition and repair, shall exercise and perform good maintenance practices. Lessee's obligations shall include restorations, replacements or renewals when necessary to keep the Premises and all improvements thereon or a can thereof in good order, condition and state of repair.

(c) If Lessee fails to perform Lessee's obligations under this

Paragraph 7.1. Lessor may enter upon the Premises after ten (10) days prior written notice to Lessee (except in the case of an emergency, in which case to notice shall be required), perform such obligations on Lessee's behalf and put the Premises in good order, condition and repair, in accordance with Paragraph 13.2 below.

7.2 LESSOR'S OBLIGATIONS. Subject to the provisions of Paragraphs 4.2 (Common Area Operating Expenses), 6 (Use), 7.1 (Lessee's Obligations), 9 (Damage or Destruction) and 14 (Condemnation). Lessor, subject to reimbursement pursuant to Paragraph 4.2 shall keep in good order, condition and repair the foundations, exterior walls, structural condition of interior bearing walls, exterior roof, fire sprinkler and/or standpipe and hose (if located in the Common Areas) or other automatic fire extinguishing system including fire alarm and/or smoke

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detection systems and equipment, fire hydrants, parking lots, walkways, parkways, driveways, landscaping, fences, signs and utility systems serving the Common Areas and all parts thereof, as well as providing the services for which there is a Common Area Operating Expense pursuant to Paragraph 4.2. Lessor shall not be obligated to paint the exterior or interior surfaces of exterior walls nor shall Lessor be obligated to maintain, repair or replace windows, doors or plate glass of the Premises. Lessee expressly waives the benefit of any statute now or hereafter in effect which would otherwise afford Lessee the right to make repairs at Lessor's expense or to terminate this Lease because of Lessor's failure to keep the Building, Industrial Center or Common Areas in good order, condition and repair.

### 7.3 UTILITY INSTALLATIONS, TRADE FIXTURES, ALTERATIONS.

(a) DEFINITIONS; CONSENT REQUIRED. The term "UTILITY INSTALLATIONS" is used in this Lease to refer to all air lines, power panels, electrical distribution, security, fire protection systems, communications systems, lighting fixtures, heating, ventilating and air conditioning equipment, plumbing, and fencing in, on or about the Premises. The term "TRADE FIXTURES" shall mean Lessee's machinery and equipment which can be removed without doing material damage to the Premises. The term "ALTERATIONS" shall mean any modification of the improvements on the Premises which are provided by Lessor under the terms of this Lease, other than Utility Installations or Trade Fixtures. "LESSEE-OWNED ALTERATIONS AND/OR UTILITY INSTALLATIONS" are defined as Alterations and/or Utility Installations made by Lessee that are not yet owned by Lessor pursuant to Paragraph 7.4(a). Lessee shall not make nor cause to be made any Alterations or Utility Installations in, on, under or about the Premises without Lessor's prior written consent. Lessee may, however, make non-structural Utility Installations to the interior of the Premises (excluding the roof) without Lessor's consent but upon notice to Lessor, so long as they are not visible from the outside of the Premises, do not involve puncturing, relocating or removing the roof or any existing walls, or changing or interfering with the fire sprinkler or fire detection systems and the cumulative cost thereof during the term of this Lease as extended does not exceed \$2,500.00.

(b) CONSENT. Any Alterations or Utility Installations that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written form with detailed plans. All consents given by Lessor, whether by virtue of Paragraph 7.3(a) or by subsequent specific consent, shall be deemed conditioned upon: (i) Lessee's acquiring all applicable permits required by governmental authorities; (ii) the furnishing of copies of such permits together with a copy of the plans and specifications for the Alteration or Utility Installation to Lessor prior to commencement of the work thereon; and (iii) the compliance by Lessee with all conditions of said permits in a prompt and expeditious manner. Any Alterations or Utility Installations by Lessee during the term of this Lease shall be done in a good and workmanlike manner, with good and sufficient materials, and be in compliance with all Applicable Requirements. Lessee shall promptly upon completion thereof furnish Lessor with as-built plans and specifications therefor. Lessor may, (but without obligation to do so) condition its consent to any requested Alteration or Utility Installation that costs \$2,500.00 or more upon Lessee's providing Lessor with a lien and completion bond in an amount equal to one and one-half times the estimated cost of such Alteration or Utility Installation.



(c) LIEN PROTECTION. Lessee shall pay when due all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use on the Premises, which claims are or may be secured by any mechanic's or materialmen's lien against the Premises or any interest therein. Lessee shall give Lessor not less than ten (10) days' notice prior to the commencement of any work in, on, or about the Premises, and Lessor shall have the right to post notices of non-responsibility in or on the Premises as provided by law. If Lessee shall, in good faith, contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense, defend and protect itself, Lessor and the Premises against the same and shall pay and satisfy any such adverse judgment that may be rendered thereon before the enforcement thereof against the Lessor or the Premises. If Lessor shall require, Lessee shall furnish to Lessor a surety bond satisfactory to Lessor in an amount equal to one and one-half times the amount of such contested lien claim or demand, indemnifying Lessor against liability for the same, as required by law for the holding of the Premises free from the effect of such lien or claim. In addition, Lessor may require Lessee to pay Lessor's attorneys' fees and costs in participating in such action if Lessor shall decide it is to its best interest to do so.

#### 7.4 OWNERSHIP, REMOVAL, SURRENDER, AND RESTORATION.

(a) OWNERSHIP. Subject to Lessor's right to require their removal and to cause Lessee to become the owner thereof as hereinafter provided in this Paragraph 7.4, all Alterations and Utility Installations made to the Premises by Lessee shall be the property of and owned by Lessee, but considered a part of the Premises. Lessor may, at any time and at its option, elect in writing to Lessee to be the owner of all or any specified part of the Lessee-Owned Alterations and Utility Installations. Unless otherwise instructed per Subparagraph 7.4(b) hereof, all Lessee-Owned Alterations and Utility Installations shall, at the expiration or earlier termination of this Lease, become the property of Lessor and remain upon the Premises and be surrendered with the Premises by Lessee.

(b) REMOVAL. Unless otherwise agreed in writing, Lessor may require that any or all Lessee-Owned Alterations or Utility Installations be removed by the expiration or earlier termination of this Lease, notwithstanding that their installation may have been consented to by Lessor. Lessor may require the removal at any time of all or any part of any Alterations or Utility Installations made without the required consent of Lessor.

(c) SURRENDER/RESTORATION. Lessee shall surrender the Premises by the end of the last day of the Lease term or any earlier termination date, clean and free of debris and in good operating order, condition and state of repair, ordinary wear and tear excepted. Ordinary wear and tear shall not include any damage or deterioration that would have been prevented by good maintenance practice or by Lessee performing all of its obligations under this Lease. Except as otherwise agreed or specified herein, the Premises, as surrendered, shall include the Alterations and Utility Installations. The obligation of Lessee shall include the repair of any damage occasioned by the installation, maintenance or removal of Lessee's Trade Fixtures, furnishings, equipment, and Lessee-Owned Alterations and Utility Installations, as well as the removal of any storage tank installed by or for Lessee, and the removal, replacement, or remediation of any soil, material or ground water contaminated by Lessee, all as may then be required by Applicable Requirements and/or good practice. Lessee's Trade Fixtures shall remain the property of Lessee and shall be removed by Lessee subject to its obligation to repair and restore the Premises per this Lease.

#### 8. INSURANCE; INDEMNITY.

8.1 PAYMENT OF PREMIUMS. The cost of the premiums for the insurance policies maintained by Lessor under this Paragraph 8 shall be a Common Area Operating Expense pursuant to Paragraph 4.2 hereof. Premiums for policy periods commencing prior to, or extending beyond, the term of this Lease shall be prorated to coincide with the corresponding Commencement Date or Expiration Date.

#### 8.2 LIABILITY INSURANCE.

(a) CARRIED BY LESSEE. Lessee shall obtain and keep in force during the term of this Lease a Commercial General Liability policy of insurance protecting Lessee, Lessor and any Lender(s) whose names have been provided to

Lessee in writing (as additional insureds) against claims for bodily injury, personal injury and property damage based upon, involving or arising out of the ownership, use, occupancy or maintenance of the Premises and all areas appurtenant thereto. Such insurance shall be on an occurrence basis providing single limit coverage in an amount not less than \$1,000,000 per occurrence with an "Additional Insured-Managers or Lessors of Premises" endorsement and contain the "Amendment of the Pollution Exclusion" endorsement for damage caused by heat, smoke or fumes from a hostile fire. The policy shall not contain any intra-insured exclusions as between insured persons or organizations, but shall include coverage for liability assumed under this Lease as an "insured contract" for the performance of Lessee's indemnity obligations under this Lease. The limits of said insurance required by this Lease or as carried by Lessee shall not, however, limit the liability of Lessee nor relieve Lessee of any obligation hereunder. All insurance to be carried by Lessee shall be primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only.

(b) CARRIED BY LESSOR. Lessor shall also maintain liability insurance described in Paragraph 8.2(a) above. In addition to and not in lieu of the insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein.

### 8.3 PROPERTY INSURANCE-BUILDING, IMPROVEMENTS AND RENTAL VALUE.

(a) BUILDING AND IMPROVEMENTS. Lessor shall obtain and keep in force during the term of this Lease a policy or policies in the name of Lessor, with loss payable to Lessor and to any Lender(s), insuring against loss or damage to the Premises. Such insurance shall be for full replacement cost, as the same shall exist from time to time, or the amount required by any Lender(s), but in no event more than the commercially reasonable and available insurable value thereof if, by reason of the unique nature or age of the improvements involved, such latter amount is less than full replacement cost. Lessee-Owned Alterations and Utility Installations, Trade Fixtures and Lessee's personal property shall be insured by Lessee pursuant to Paragraph 8.4. If the coverage is available and commercially appropriate, Lessor's policy or policies shall insure against all risks of direct physical loss or damage (except the perils of flood and/or earthquake unless required by a Lender), including coverage for any additional costs resulting from debris removal and reasonable amounts of coverage for the enforcement of any ordinance or law regulating the reconstruction or replacement of any undamaged sections of the Building required to be demolished or removed by reason of the enforcement of any building, zoning, safety or land use laws as the result of a covered loss, but not including plate glass insurance. Said policy or policies shall also contain an agreed valuation provision in lieu of any co-insurance clause, waiver of subrogation, and inflation guard protection causing an increase in the annual property insurance coverage amount by a factor of not less than the adjusted U.S. Department of Labor Consumer Price Index for All Urban Consumers for the city nearest to where the Premises are located.

(b) RENTAL VALUE. Lessor may also obtain and keep in force during the term of this Lease a policy or policies in the name of Lessor, with loss payable to Lessor and any Lender(s), insuring the loss of the full rental and other charges payable by all lessees of the Building to Lessor for one year (including all Real Property Taxes, insurance costs, all Common Area Operating Expenses and any scheduled rental increases). Said insurance may provide that in the event the Lease is terminated by reason of an insured loss, the period of indemnity for such coverage shall be extended beyond the date of the completion of repairs or replacement of the Premises to provide for one full year's loss of rental revenues from the date of any such loss. Said insurance shall contain an agreed valuation provision in lieu of any co-insurance clause, and the amount of coverage shall be adjusted annually to reflect the projected rental income. Real Property Taxes, insurance premium costs and other expenses, if any, otherwise payable, for the next 12-month period. Common Area Operating Expenses shall include any deductible amount in the event of such loss.

(c) ADJACENT PREMISES. Lessee shall pay for any increase in the premiums for the property insurance of the Building and for the Common Areas or other buildings in the Industrial Center if said increase is caused by Lessee's acts, omissions, use or occupancy of the Premises.

(d) LESSEE'S IMPROVEMENTS. Since Lessor is the Insuring Party, Lessor shall not be required to insure Lessee-Owned Alterations and Utility Installations.

8.4 LESSEE'S PROPERTY INSURANCE. Subject to the requirements of Paragraph 8.5, Lessee at its cost shall either by separate policy or, at Lessor's option, by endorsement to a policy already carried, maintain insurance coverage on all of Lessee's personal property. Trade Fixtures and Lessee-Owned Alterations and Utility Installations in, on or about the Premises similar in coverage to that carried by Lessor as the Insuring Party under Paragraph 8.3(a). Such insurance shall be full replacement cost coverage with a deductible not to exceed \$1,000 per occurrence. The proceeds from any such insurance shall be used by Lessee for the replacement of personal property and the restoration of Trade Fixtures and Lessee-Owned Alterations and Utility Installations. Upon request from Lessor, Lessee shall provide Lessor with written evidence that such insurance is in force.

8.5 INSURANCE POLICIES. Insurance required hereunder may be maintained by Lessee under a blanket policy or policies and shall be in companies duly licensed to transact business in the state where the Premises are located, and maintaining during the policy term a "General Policyholders Rating" of at least B+, V, or such other rating as may be required by a Lender, as set forth in the most current issue of "Best's Insurance Guide," Lessee shall not do or permit to be done anything which shall invalidate the insurance policies referred to in

\* may be maintained by Lessee under a blanket policy or policies and this Paragraph 8. Lessee shall cause to be delivered to Lessor, within seven (7) days after the earlier of the Early Possession Date or the Commencement Date, certified copies of, or certificates evidencing the existence and amounts of, the Insurance required under Paragraph 8.2(a) and 8.4. No such policy shall be cancelable or subject to modification except after thirty (30) days' prior written notice to Lessor. Lessee shall at least thirty (30) days prior to the expiration of such policies, furnish Lessor with evidence of renewals or "Insurance binders" evidencing renewal thereof, or Lessor may order such insurance and charge the cost thereof to Lessee, which amount shall be payable by Lessee to Lessor upon demand.

8.6 WAIVER OF SUBROGATION. Without affecting any other rights or remedies, Lessee and Lessor each hereby release and relieve the other, and waive their entire right to recover damages (whether in contract or in tort) against the other, for loss or damage to their property arising out of or incident to the perils required to be insured against under Paragraph 8. The effect of such releases and waivers of the right to recover damages shall not be limited by the amount of insurance carried or required, or by any deductibles applicable thereto. Lessor and Lessee agree to have their respective insurance companies issuing property damage insurance waive any right to subrogation that such companies may have against Lessor or Lessee, as the case may be, so long as the insurance is not invalidated thereby.

8.7 INDEMNITY. Except for Lessor's negligence and/or breach of express warranties, Lessee shall indemnify, protect, defend and hold harmless the Premises, Lessor and its agents, Lessor's master or ground lessor, partners and Lenders, from and against any and all claims, loss of rents and/or damages, costs, liens, judgments, penalties, loss of permits, attorneys' and consultants' fees, expenses and/or liabilities arising out of, involving, or in connection with, the occupancy of the Premises by Lessee, the conduct of Lessee's business, any act, omission or neglect of Lessee, its agents, contractors, employees or invitees, and out of any Default or Breach by Lessee in the performance in a timely manner of any obligation on Lessee's part to be performed under this Lease. The foregoing shall include, but not be limited to, the defense or pursuit of any claim or any action or proceeding involved therein, and whether or not (in the case of claims made against Lessor) litigated and/or reduced to judgment. In case any action or proceeding be brought against Lessor by reason of any of the foregoing matters, Lessee upon notice from Lessor shall defend the same at Lessee's expense by counsel reasonably satisfactory to Lessor and Lessor shall cooperate with Lessee in such defense. Lessor need not have first paid any such claim in order to be so indemnified.

8.8 EXEMPTION OF LESSOR FROM LIABILITY. Lessor shall not be liable for injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessee's employees, contractors, invitees, customers or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires,

appliances, plumbing, air conditioning or lighting fixtures, or from any other cause, whether said injury or damage results from conditions arising upon the Premises or upon other portions of the Building of which the Premises are a part, from other sources or places, and regardless of whether the cause of such damage or injury or the means of repairing the same is accessible or not. Lessor shall not be liable for any damages arising from any act or neglect of any other lessee of Lessor nor from the failure by Lessor to enforce the provisions of any other lease in the Industrial Center. Notwithstanding Lessor's negligence or breach of this Lease. Lessor shall under no circumstances be liable for injury to Lessee's business or for any loss of income or profit therefrom.

## 9. DAMAGE OR DESTRUCTION.

### 9.1 DEFINITIONS.

(a) "PREMISES PARTIAL DAMAGE" shall mean damage or destruction to the Premises, other than Lessee-Owned Alterations and Utility Installations, the repair cost of which damage or destruction is less than fifty percent (50%) of the then Replacement cost (as defined in Paragraph 9.1(d)) of the Premises (excluding Lessee-Owned Alterations and Utility Installations and Trade Fixtures) immediately prior to such damage or destruction.

(b) "PREMISES TOTAL DESTRUCTION" shall mean damage or destruction to the Premises, other than Lessee-Owned Alterations and Utility Installations, the repair cost of which damage or destruction is fifty percent (50%) or more of the then Replacement Cost of the Premises (excluding Lessee-Owned Alterations and Utility Installations and Trade Fixtures) immediately prior to such damage or destruction. In addition, damage or destruction to the Building, other than Lessee-Owned Alterations and Utility Installations and Trade Fixtures of any lessees of the Building, the cost of which damage or destruction is fifty percent (50%) or more of the then Replacement Cost (excluding Lessee-Owned Alterations and Utility Installations and Trade Fixtures of any lessees of the Building) of the Building shall, at the option of Lessor, be deemed to be Premises Total Destruction.

(c) "INSURED LOSS" shall mean damage or destruction to the Premises, other than Lessee-Owned Alterations and Utility Installations and Trade Fixtures, which was caused by an event required to be covered by the insurance described in Paragraph 8.3(a) irrespective of any deductible amounts or coverage limits involved.

(d) "REPLACEMENT COST" shall mean the cost to repair or rebuild the improvements owned by Lessor at the time of the occurrence to their condition existing immediately prior thereto, including demolition, debris removal and upgrading required by the operation of applicable building codes, ordinances or laws, and without deduction for depreciation.

(e) "HAZARDOUS SUBSTANCE CONDITION" shall mean the occurrence or discovery of a condition involving the presence of, or a contamination by, a Hazardous Substance as defined in Paragraph 6.2(a), in, on, or under the Premises.

9.2 PREMISES PARTIAL DAMAGE - INSURED LOSS. If Premises Partial Damage that is an Insured Losses occurs, then Lessor shall, at Lessor's expense, repair such damage (but not Lessee's Trade Fixtures or Lessee-Owned Alterations and Utility Installations) as soon as reasonably possible and this Lease shall continue in full force and effect. In the event, however, that there is a shortage of insurance proceeds and such shortage is due to the fact that, by reason of the unique nature of the improvements in the Premises, full replacement cost insurance coverage was not commercially reasonable and available, Lessor shall have no obligation to pay for the shortage in insurance proceeds or to fully restore the unique aspects of the Premises unless Lessee provides Lessor with the funds to cover same, or adequate assurance thereof, within ten (10) days following receipt of written notice of such shortage and request therefor. If Lessor receives said funds or adequate assurance thereof within said ten (10) day period, Lessor shall complete them as soon as reasonably possible and this Lease shall remain in full force and effect. If Lessor does not receive such funds or assurance within said period, Lessor may nevertheless elect by written notice to Lessee within ten (10) days thereafter to make such restoration and repair as is commercially reasonable with Lessor paying any shortage in proceeds, in which case this Lease shall remain in full force and effect. If Lessor does not receive such funds or assurance within such ten (10) day period, and if Lessor does not so elect to restore and

repair, then this Lease shall terminate sixty (60) days following the occurrence of the damage or destruction. Unless otherwise agreed, Lessee shall in no event have any right to reimbursement from Lessor for any funds contributed by Lessee to repair any such damage or destruction. Premise Partial Damage due to flood or earthquake shall be subject to Paragraph 9.3 rather than Paragraph 9.2, notwithstanding that there may be some insurance coverage, but the net proceeds of any such insurance shall be made available for the repairs if made by either Party.

9.3 PARTIAL DAMAGE - UNINSURED LOSS. If Premises Partial Damage that is not an Insured Loss occurs, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessee's expense and this Lease shall continue in full force and effect), Lessor may at Lessor's option, either (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) give written notice to Lessee within thirty (30) days after receipt by Lessor of knowledge of the occurrence of such damage of Lessor's desire to terminate this Lease as of the date sixty (60) days following the date of such notice. In the event Lessor elects to give such notice of Lessor's intention to terminate this Lease, Lessee shall have the right within ten (10) days after the receipt of such notice to give written notice to Lessor of Lessee's commitment to pay for the repair of such damage totally at Lessee's expense and without reimbursement from Lessor. Lessee shall provide Lessor with the required funds or satisfactory assurance thereof within thirty (30) days following such commitment from Lessee. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such repairs as soon as reasonably possible after the required funds are available. If Lessee does not give such notice and provide the funds or assurance thereof within the times specified above, this Lease shall terminate as of the date specified in Lessor's notice of termination.

9.4 TOTAL DESTRUCTION. Notwithstanding any other provision hereof, if Premises Total Destruction occurs (including any destruction required by any authorized public authority), this Lease shall terminate sixty (60) days following the date of such Premises Total Destruction, whether or not the damage or destruction is an Insured Loss or was caused by a negligent or willful act of Lessee. In the event, however, that the damage or destruction was caused by Lessee, Lessor shall have the right to recover Lessor's damages from Lessee except as released and waived in Paragraph 9.7.

9.5 DAMAGE NEAR END OF TERM. If at any time during the last six (6) months of the term of this Lease there is damage for which the cost to repair exceeds one month's Base Rent, whether or not an Insured Loss, Lessor may, at Lessor's option, terminate this Lease effective sixty (60) days following the date of occurrence of such damage by giving written notice to Lessee of Lessor's election to do so within thirty (30) days after the date of occurrence of such damage. Provided, however, if Lessee at that time has an exercisable option to extend this Lease or to purchase the Premises, then Lessee may preserve this Lease by (a) exercising such option, and (b) providing Lessor with any shortage in insurance proceeds (or adequate assurance thereof) needed to make the repairs on or before the earlier of (i) the date which is ten (10) days after Lessee's receipt of Lessor's written notice purporting to terminate this Lease, or (ii) the day prior to the date upon which such option expires. If Lessee duly exercises such option during such period and provides Lessor with funds (or adequate assurance thereof) to cover any shortage in insurance proceeds, Lessor shall, at Lessor's expense repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect. If Lessee fails to exercise such option and provide such funds or assurance during such period, then this Lease shall terminate as of the case set forth in the first sentence of this Paragraph 9.5.

#### 9.6 ABATEMENT OF RENT; LESSEE'S REMEDIES.

(a) In the event of (i) Premises Partial Damage or (ii) Hazardous Substance Condition for which Lessee is not legally responsible, the Base Rent, Common Area Operating Expenses and other charges, if any, payable by Lessee hereunder for the period during which such damage or condition, its repair, remediation or restoration continues, shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired, but not in excess of proceeds from insurance required to be carried under Paragraph 9.3(b). Except for abatement of Base Rent, Common Area Operating Expenses and other charges, if any, as aforesaid, all other obligations of Lessee hereunder shall be performed by Lessee, and Lessee shall have no claim against Lessor for any

damage suffered by reason of any such damage, destruction, repair, remediation or restoration.

(b) If Lessor shall be obligated to repair or restore the Premises under the provisions of this Paragraph 9 and shall not commence, in a substantial and meaningful way, the repair or restoration of the Premises within ninety (90) days after such obligation shall accrue, Lessee may, at any time prior to the commencement of such repair or restoration, give written notice to Lessor and to any Lenders of which Lessee has actual notice of Lessee's election to terminate this Lease on a date not less than sixty (60) days following the giving of such notice. If Lessee gives such notice to Lessor and such Lenders and such repair or restoration is not commenced within thirty (30) days after receipt of such notice, this Lease shall terminate as of the date specified in said notice. If Lessor or a Lender commences the repair or restoration of the Premises within thirty (30) days after the receipt of such notice, this Lease shall continue in full force and effect. "Commence" as used in this Paragraph 9.6 shall mean either the unconditional authorization or the preparation of the required plans, or the beginning of the actual work on the Premises, whichever occurs first.

9.7 HAZARDOUS SUBSTANCE CONDITIONS. If a Hazardous Substance Condition occurs, unless Lessee is legally responsible therefor (in which case Lessee shall make the investigation and remediation thereof required by Applicable Requirements and this Lease shall continue in full force and effect but subject

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to Lessor's rights under Paragraph 6.2(c) and Paragraph 13), Lessor may at Lessor's option either (i) investigate and remediate such Hazardous Substance Condition, if required, as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) if the estimated cost to investigate and remediate such condition exceeds twelve (12) times the then monthly Base Rent or \$100,000, whichever is greater, give written notice to Lessee within thirty (30) days after receipt by Lessor of knowledge of the occurrence of such Hazardous Substance Condition of Lessor's desire to terminate this Lease as of the date sixty (60) days following the date of such notice. In the event Lessor elects to give such notice of Lessor's intention to terminate this Lease, Lessee shall have the right within ten (10) days after the receipt of such notice to given written notice to Lessor of Lessee's commitment to pay for the excess costs of (a) investigation and remediation of such Hazardous Substance Condition to the extent required by Applicable Requirements, over (b) an amount equal to twelve (12) times the then monthly Base Rent or \$100,000, whichever is greater. Lessee shall provide Lessor with the funds required of Lessee as satisfactory assurance thereof within thirty (30) days following said commitment by Lessee. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such investigation and remediation as soon as reasonably possible after the required funds are available. If Lessee does not give such notice and provide the required funds or assurance thereof within the time period specified above, this Lease shall terminate as of the date specified in Lessor's notice of termination.

9.8 TERMINATION - ADVANCE PAYMENTS. Upon termination of this Lease pursuant to this Paragraph 9, Lessor shall return to Lessee any advance payment made by Lessee to Lessor and so much of Lessee's Security Deposit as has not been, or is not then required to be, used by Lessor under the terms of this Lease.

9.9 WAIVER OF STATUTES. Lessor and Lessee agree that the terms of this Lease shall govern the effect of any damage to or destruction of the Premises and the Building with respect to the termination of this Lease and hereby waive the provisions of any present or future statute to the extent it is inconsistent herewith.

## 10. REAL PROPERTY TAXES.

10.1 PAYMENT OF TAXES. Lessor shall pay the Real Property Taxes, as defined in Paragraph 10.2, applicable to the Industrial Center, and except as otherwise provided in Paragraph 10.3, any such amounts shall be included in the calculation of Common Area Operating Expenses in accordance with the provisions of Paragraph 4.2.

10.2 REAL PROPERTY TAX DEFINITION. As used herein, the term "REAL PROPERTY TAXES" shall include any form of real estate tax or assessment,

general, special, ordinary or extraordinary, and any license fee, commercial rental tax, improvement bond or bonds, levy or tax (other than inheritance, personal income or estate taxes) imposed upon the Industrial Center by any authority having the direct or indirect power to tax, including any city, state or federal government, or any school, agricultural, sanitary, fire, street, drainage, or other improvement district thereof, levied against any legal or equitable interest of Lessor in the Industrial Center or any portion thereof, lessor's right to rent or other income therefrom, and/or Lessor's business of leasing the Premises. The term "REAL PROPERTY TAXES" shall also include any tax, fee, levy, assessment or charge, or any increase therein, imposed by reason of events occurring, or changes in Applicable Law taking effect, during the term of this Lease, including but not limited to a change in the ownership of the Industrial Center or in the improvements thereon, the execution of this Lease, or any modification, amendment or transfer thereof, and whether or not contemplated by the Parties. In calculating Real Property Taxes for any calendar year, the Real Property Taxes for any real estate year shall be included in the calculation of Real Property Taxes for such calendar year based upon the number of days which such calendar year and tax year have in common.

10.3 ADDITIONAL IMPROVEMENTS. Common Area Operating Expenses shall not include Real Property Taxes specified in the tax assessor's records and work sheets as being caused by additional improvements placed upon the Industrial Center by other lessees or by Lessor for the exclusive enjoyment of such other lessees. Notwithstanding Paragraph 10.1 hereof, Lessee shall, however, pay to Lessor at the time Common Area Operating Expenses are payable under Paragraph 4.2, the entirety of any increase in Real Property Taxes if assessed solely by reason of Alterations, Trade Fixtures or Utility Installations placed upon the Premises by Lessee or at Lessee's request.

10.4 JOINT ASSESSMENT. If the Building is not separately assessed, Real Property Taxes allocated to the Building shall be an equitable proportion of the Real Property Taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available. Lessor's reasonable determination thereof, in good faith, shall be conclusive.

10.5 LESSEE'S PROPERTY TAXES. Lessee shall pay prior to delinquency all taxes assessed against and levied upon Lessee-Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all personal property of Lessee contained in the Premises or stored within the Industrial Center. When possible, Lessee shall cause its Lessee-Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor. If any of Lessee's said property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee's property within ten (10) days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. UTILITIES. Lessee shall pay directly for all utilities and services supplied to the Premises, including but not limited to electricity, telephone, security, gas and cleaning of the Premises, together with any taxes thereon. If any such utilities or services are not separately metered to the Premises or separately billed to the Premises, Lessee shall pay to Lessor a reasonable proportion to be determined by Lessor of all such charges jointly metered or billed with other premises in the Building, in the manner and within the time periods set forth in Paragraph 4.2(d).

12. ASSIGNMENT AND SUBLETTING.

12.1 LESSOR'S CONSENT REQUIRED.

(a) Lessee shall not voluntarily or by operation of law assign, transfer, mortgage or otherwise transfer or encumber (collectively, "assign") or sublet all or any part of Lessee's interest in this Lease or in the Premises without Lessor's prior written consent given under and subject to the terms of Paragraph 36.

(b) A change in the control of Lessee shall constitute an assignment requiring Lessor's consent. The transfer, on a cumulative basis, of twenty-five percent (25%) or more of the voting control of Lessee shall constitute a change in control for this purpose.

(c) The involvement of Lessee or its assets in any transaction, or series of transactions (by way of merger, sale, acquisition, financing, refinancing, transfer, leveraged buy-out or otherwise), whether or not a formal assignment or hypothecation of this Lease or Lessee's assets occurs, which results or will result in a reduction of the Net Worth of Lessee, as hereinafter defined, by an amount equal to or greater than twenty-five percent (25%) of such Net Worth of Lessee as it was represented to Lessor at the time of full execution and delivery of this Lease or at the time of the most recent assignment to which Lessor has consented, or as it exists immediately prior to said transaction or transactions constituting such reduction, at whichever time said Net Worth of Lessee was or is greater, shall be considered an assignment of this Lease by Lessee to which Lessor may reasonably withhold its consent. "NET WORTH OF LESSEE" for purposes of this Lease shall be the net worth of Lessee (excluding any Guarantors) established under generally accepted accounting principles consistently applied.

(d) An assignment or subletting of Lessee's interest in this Lease without Lessor's specific prior written consent shall, at Lessor's option, be a Default curable after notice per Paragraph 13.1, or a non-curable Breach without the necessity of any notice and grace period. If Lessor elects to treat such unconsented to assignment or subletting as a non-curable Breach, Lessor shall have the right to either: (i) terminate this Lease, or (ii) upon thirty (30) days' written notice ("LESSOR'S NOTICE"), increase the monthly Base Rent for the Premises to the greater of the then fair market rental value of the Premises, as reasonably determined by Lessor, or one hundred ten percent (110%) of the Base Rent then in effect. Pending determination of the new fair market rental value, if disputed by Lessee. Lessee shall pay the amount set forth in Lessor's Notice, with any overpayment credited against the next installment(s) of Base Rent coming due, and any underpayment for the period retroactively to the effective date of the adjustment being due and payable immediately upon the determination thereof. Further, in the event of such Breach and rental adjustment, (i) the purchase price of any option to purchase the Premises held by Lessee shall be subject to similar adjustment to the then fair market value as reasonably determined by Lessor (without the Lease being considered an encumbrance or any deduction for depreciation or obsolescence, and considering the Premises at its highest and best use and in good condition) or one hundred ten percent (110%) of the price previously in effect, (ii) any index-oriented rental or price adjustment formulas contained in this Lease shall be adjusted to require that the base index be determined with reference to the index applicable to the time of such adjustment, and (iii) any fixed rental adjustments scheduled during the remainder of the Lease term shall be increased in the same ratio as the new rental bears to the Base Rent in effect immediately prior to the adjustment specified in Lessor's Notice.

(e) Lessee's remedy for any breach of this Paragraph 12.1 by Lessor shall be limited to compensatory damages and/or injunctive relief.

## 12.2 TERMS AND CONDITIONS APPLICABLE TO ASSIGNMENT AND SUBLETTING.

(a) Regardless of Lessor's consent, any assignment or subletting shall not (i) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (ii) release Lessee of any obligations hereunder, nor (iii) after the primary liability of Lessee for the payment of Base Rent and other sums due Lessor hereunder or for the performance of any other obligations to be performed by Lessee under this Lease.

(b) Lessor may accept any rent or performance of Lessee's obligations from any person other than Lessee pending approval or disapproval of an assignment. Neither a delay in the approval or disapproval of such assignment nor the acceptance of any rent for performance shall constitute a waiver or estoppel of Lessor's right to exercise its remedies for the Default or Breach by Lessee of any of the terms, covenants or conditions of this Lease.

(c) The consent of Lessor to any assignment or subletting shall not constitute a consent to any subsequent assignment or subletting by Lessee or to any subsequent or successive assignment or subletting by the assignee or sublessee. However, Lessor may consent to subsequent sublettings and assignments of the sublease or any amendments or modifications thereto without notifying Lessee or anyone else liable under this Lease or the sublease and without obtaining their consent, and such action shall not relieve such persons from liability under this Lease or the sublease.



(d) In the event of any Default or Breach of Lessee's obligation under this Lease, Lessor may proceed directly against Lessee, any Guarantors or anyone else responsible for the performance of the Lessee's obligations under this Lease, including any sublessee, without first exhausting Lessor's remedies against any other person or entity responsible therefor to Lessor, or any security held by Lessor.

(e) Each request for consent to an assignment or subletting shall be in writing, accompanied by information relevant to Lessor's determination as to the financial and operational responsibility and appropriateness of the proposed assignee or sublessee, including but not limited to the intended use and/or required modification of the Premises, if any, together with a non-refundable deposit of \$1,000 or ten percent (10%) of the monthly Base Rent applicable to the portion of the Premises which is the subject of the proposed assignment or sublease, whichever is greater, as reasonable consideration for Lessor's considering and processing the request for consent, Lessee agrees to provide Lessor with such other or additional information and/or documentation as may be reasonably requested by Lessor.

(f) Any assignee of, or sublessee under, this Lease shall, by reason of accepting such assignment or entering into such sublease, be deemed, for the benefit of Lessor, to have assumed and agreed to conform and comply with each and every term, covenant, condition and obligation herein to be observed or performed by Lessee during the term of said assignment or sublease, other than such obligations as are contrary to or inconsistent with provisions of an assignment or sublease to which Lessor has specifically consented in writing.

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(g) The occurrence of a transaction described in Paragraph 12.2(c) shall give Lessor the right (but not the obligation) to require that the Security Deposit be increased by an amount equal to six (6) times the then monthly Base Rent, and Lessor may make the actual receipt by Lessor of the Security Deposit increase a condition to Lessor's consent to such transaction.

(h) Lessor, as a condition to giving its consent to any assignment or subletting, may require that the amount and adjustment schedule of the rent payable under this Lease be adjusted to what is then the market value and/or adjustment schedule for property similar to the Premises as then constituted, as determined by Lessor.

12.3 ADDITIONAL TERMS AND CONDITIONS APPLICABLE TO SUBLETTING. The following terms and conditions shall apply to any subletting by Lessee of all or any part of the Premises and shall be deemed included in all subleases under this Lease whether or not expressly incorporated therein;

(a) Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all rentals and income arising from any sublease of all or a portion of the Premises heretofore or hereafter made by Lessee, and Lessor may collect such rent and income and apply same toward Lessee's obligations under this Lease; provided, however, that until a Breach (as defined in Paragraph 13.1) shall occur in the performance of Lessee's obligations under this Lease, Lessee may, except as otherwise provided in this Lease, receive, collect and enjoy the rents accruing under such sublease. Lessor shall not, by reason of the foregoing provision or any other assignment of such sublease to Lessor, nor by reason of the collection of the rents from a sublessee, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee under such Sublease. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice from Lessor stating that a Breach exists in the performance of Lessee's obligations under this Lease, to pay to Lessor the rents and other charges due and to become due under the sublease. Sublessee shall rely upon any such statement and request from Lessor and shall pay such rents and other charges to lessor without any obligation or right to inquire as to whether such Breach exists and notwithstanding any notice from or claim from Lessee to the contrary. Lessee shall have no right or claim against such sublessee, or, until the Breach has been cured, against Lessor, for any such rents and other charges so paid by said sublessee to Lessor.

(b) In the event of a Breach by Lessee in the performance of its obligations under this Lease, Lessor, at its option and without any obligation to do so, may require any sublessee to attorn to Lessor, in which event Lessor

shall undertake the obligations of the sublessor under such sublease from the time of the exercise of said option to the expiration of such sublease; provided, however, Lessor shall not be liable for any prepaid rents or security deposit paid by such sublessee to such sublessor or for any other prior defaults or breaches of such sublessor under such sublease.

(c) Any matter or thing requiring the consent of the sublessor under a sublease shall also require the consent of Lessor herein.

(d) No sublessee under a sublease approved by Lessor shall further assign or sublet all or any part of the Premises without Lessor's prior written consent.

(e) Lessor shall deliver a copy of any such notice of Default or Breach by Lessee to the sublessee, who shall have the right to cure the Default of Lessee within the grace period, if any, specified in such notice. The sublessee shall have a right of reimbursement and offset from and against Lessee for any such Defaults cured by the sublessee. See paragraph 55

### 13. DEFAULT; BREACH; REMEDIES.

13.1 DEFAULT; BREACH. Lessor and Lessee agree that if an attorney is consulted by Lessor in connection with a Lease Default or Breach (as hereinafter defined), \$350.00 is a reasonable minimum sum per such occurrence for legal services and costs in the preparation and service of a notice of Default, and that Lessor may include the cost of such services and costs in said notice as rent due and payable to cure said default. A "Default" by Lessee is defined as a failure by Lessee to observe, comply with or perform any of the terms, covenants, conditions or rules applicable to Lessee under this lease. A "Breach" by Lessee is defined as the occurrence of any one or more of the following Defaults, and, where a grace period for cure after notice is specified herein, the failure by Lessee to cure such Default prior to the expiration of the applicable grace period, and shall entitle Lessor to pursue the remedies set forth in Paragraphs 13.2 and/or 13.3:

(a) The vacating of the Premises without the intention to reoccupy same, or the abandonment of the Premises.

(b) Except as expressly otherwise provided in this Lease, the failure by Lessee to make any payment of Base Rent, Lessee's Share of Common Area Operating Expenses, or any other monetary payment required to be made by Lessee hereunder as and when due, the failure by Lessee to provide Lessor with reasonable evidence of insurance or surety bond required under this Lease, or the failure of Lessee to fulfill any obligation under this Lease which endangers or threatens life or property, where such failure continues for a period of three (93) days following written notice thereof by or on behalf of Lessor to Lessee.

(c) Except as expressly otherwise provided in this Lease, the failure by lessee to provide Lessor with reasonable written evidence (in duly executed original form, if applicable) of (i) compliance with Applicable Requirements per Paragraph 6.3, (ii) the inspection, maintenance and service contracts required under Paragraph 7.1(b), (iii) the rescission of an unauthorized assignment or subletting per Paragraph 12.1, (iv) a Tenancy Statement per Paragraphs 16 or 37, (v) the subordination or non-subordination of this Lease per Paragraph 30, (vi) the guaranty of the performance of Lessee's obligations under this Lease if required under Paragraphs 1.11 and 37, (vii) the execution of any document requested under Paragraph 42 (easements), or (viii) any other documentation or information which Lessor may reasonably require of Lessee under the terms of this lease, where any such failure continues for a period of ten (10) days following written notice by or on behalf of Lessor to Lessee.

(d) A Default by Lessee as to the terms, covenants, conditions or provisions of this Lease, or of the rules adopted under Paragraph 40 hereof that are to be observed, complied with or performed by Lessee, other than those described in Subparagraphs 13.1(a), (b) or (c), above, where such Default continues for a period of thirty (30) days are reasonably required for its cure, then it shall not be deemed to be a Breach of this Lease by Lessee if Lessee commences such cure within said thirty (30) day period and thereafter diligently prosecutes such cure to completion.

(e) The occurrence of any of the following events: (i) the making by

Lessee of any general arrangement or assignment for the benefit of creditors; (ii) Lessee's becoming a "debtor" as defined in 11 U.S. Code Section 101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within sixty (60) days); where possession is not restored to Lessee within thirty (30) days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged within thirty (30) days; provided, however, in the event that any provision of this Subparagraph 13.1(e) is contrary to any applicable law, such provision shall be of no force or effect, and shall not affect the validity of the remaining provisions.

(f) The discovery by Lessor that any financial statement of Lessee or of any Guarantor, given to Lessor by Lessee or any Guarantor, was materially false.

13.2 REMEDIES. If Lessee fails to perform any affirmative duty or obligation of Lessee under this Lease, within ten (10) days after written notice to Lessee (or in case of an emergency, without notice), Lessor may at its option (but without obligation to do so), perform such duty or obligation on Lessee's behalf, including but not limited to the obtaining of reasonably required bonds, insurance policies, or governmental licenses, permits or approvals. The costs and expenses of any such performance by Lessor shall be due and payable by Lessee to Lessor upon invoice therefor. If any check given to Lessor by Lessee shall not be honored by the bank upon which it is drawn, Lessor, at its own option, may require all future payments to be made under this Lease by Lessee to be made only by cashier's check. In the event of a Breach of this Lease by Lessee (as defined in Paragraph 13.1), with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such Breach, Lessor may:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease and the term hereof shall terminate and Lessee shall immediately surrender possession of the Premises to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the worth at the time of the award of the unpaid rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided; and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by the Lessee's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, including but not limited to the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorneys' fees, and that portion of any leasing commission paid by Lessor in connection with this Lease applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provision (iii) of the immediately preceding sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco or the Federal Reserve Bank District in which the Premises are located at the time of award plus one percent (1%). Efforts by Lessor to mitigate damages caused by Lessee's Default or Breach of this Lease shall not waive Lessor's right to recover damages under this Paragraph 13.2. If termination of this Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding the unpaid rent and damages as are recoverable therein, or Lessor may reserve the right to recover all or any part thereof in a separate suit for such rent and/or damages. If a notice and grace period required under Subparagraph 13.1(b), (c) or (d) was not previously given, a notice to pay rent or quit, or to perform or quit, as the case may be, given to Lessee under any statute authorizing the forfeiture of leases for unlawful detainer shall also constitute the applicable notice for grace period purposes required by Subparagraph 13.1(b), (c) or (d). In such case, the applicable grace period under the unlawful detainer statute shall run concurrently after the one such statutory notice, and the failure of Lessee to cure the Default within the greater of the two (2) such grace periods shall constitute both an unlawful detainer and a Breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession in effect

(in California under California Civil Code Section 1951.4) after Lessee's Breach and recover the rent as it becomes due, provided Lessee has the right to sublet or assign, subject only to reasonable limitations. Lessor and Lessee agree that the limitations on assignment and subletting in this Lease are reasonable. Acts of maintenance or preservation, efforts to relet the Premises, or the appointment of a receiver to protect the Lessor's interest under this Lease, shall not constitute a termination of the Lessee's right to possession.

(c) Pursue any other remedy now or hereafter available to Lessor under the laws or judicial decisions of the state wherein the Premises are located.

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(d) The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

13.4 LATE CHARGES. Lessee hereby acknowledges that late payment by Lessee to Lessor of rent and other sums due hereunder will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed upon Lessor by the terms of any ground lease, mortgage or deed of trust covering the Premises. Accordingly, if any installment of rent or other sum due from Lessee shall not be received by Lessor or Lessor's designee within ten (10) days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall pay to Lessor a late charge equal to six percent (6%) of such overdue amount. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of late payment by Lessee. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's Default or Breach with respect to such overdue amount, nor prevent Lessor from exercising any of the other rights and remedies granted hereunder. In the event that a late charge is payable hereunder, whether or not collected, for three (3) consecutive installments of Base Rent, then notwithstanding Paragraph 4.1 or any other provision of this Lease to the contrary, Base Rent shall, at Lessor's option, become due and payable quarterly in advance.

13.5 BREACH BY LESSOR. Lessor shall not be deemed in breach of this Lease unless Lessor fails except in cases of emergency within a reasonable time to perform an obligation required to be performed by Lessor. For purposes of this Paragraph 13.5, a reasonable time shall in no event be less than thirty (30) days after receipt by Lessor, and by any Lender(s) whose name and address shall have been furnished to Lessee in writing for such purpose, of written notice specifying wherein such obligation of Lessor has not been performed; provided, however, that if the nature of Lessor's obligation is such that more than thirty (30) days after such notice are reasonably required for its performance, then Lessor shall not be in breach of this Lease if performance is commenced within such thirty (30) day period and thereafter diligently pursued to completion.

14. CONDEMNATION. If the Premises or any portion thereof are taken under the power of eminent domain or sold under the threat of the exercise of said power (all of which are herein called "condemnation"), this Lease shall terminate as to the part so taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than ten percent (10%) of the floor area of the Premises, or more than twenty-five percent (25%) of the portion of the Common Areas designated for Lessee's parking, is taken by condemnation, Lessee may, at Lessee's option, to be exercised in writing within ten (10) days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within ten (10) days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the Base Rent shall be reduced in the same proportion as the rentable floor area of the Premises taken bears to the total rentable floor area of the Premises. No reduction of Base Rent shall occur if the condemnation does not apply to any portion of the Premises. Any award for the taking of all or any part of the Premises under the power of eminent domain or any payment made under threat of the exercise of such power shall be the property of Lessor, whether such award shall be made as compensation for diminution of value of the leasehold or for the taking of the fee, or as severance damages; provided, however, that Lessee shall be entitled

to any compensation, separately awarded to Lessee for Lessee's relocation expenses and/or loss of Lessee's Trade Fixtures. In the event that this Lease is not terminated by reason of such condemnation, Lessor shall to the extent of its net severance damages received, over and above Lessee's Share of the legal and other expenses incurred by Lessor in the condemnation matter, repair any damage to the Premises caused by such condemnation authority. Lessee shall be responsible for the payment of any amount in excess of such net severance damages required to complete such repair.

#### 16. TENANCY AND FINANCIAL STATEMENTS.

16.1 TENANCY STATEMENT. Each Part (as "RESPONDING PARTY") shall within ten (10) days after written notice from the other Party (the "REQUESTING PARTY") execute, acknowledge and deliver to the Requesting party a statement in writing in a form similar to the then most current "TENANCY STATEMENT" form published by the American Industrial Real Estate Association, plus such additional information, confirmation and/or statements as may be reasonably requested by the Requesting Party.

16.2 FINANCIAL STATEMENT. If Lessor desires to finance, refinance, or sell the Premises or the Building, or any part thereof, Lessee and all Guarantors shall deliver to any potential lender or purchaser designated by Lessor such financial statements of Lessee and such Guarantors as may be reasonably required by such Lendor or purchaser, including but not limited to Lessee's financial statements for the past three (3) years. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. LESSOR'S LIABILITY. The term "Lessor" as used herein shall mean the owner or owners at the time in question of the fee title to the Premises. In the event of a transfer of Lessor's title or interest in the Premises or in this Lease, Lessor shall deliver to the transferee or assignee (in cash or by credit) any unused Security Deposit held by Lessor at the time of such transfer or assignment. Except as provided in Paragraph 15.3, upon such transfer or assignment and delivery of the Security Deposit, as aforesaid, the prior Lessor shall be relieved of all liability with respect to the obligations and/or covenants under this Lease thereafter to be performed by the Lessor. Subject to the foregoing, the obligations and/or covenants in this Lease to be performed by the Lessor shall be binding only upon the Lessor as hereinabove defined.

18. SEVERABILITY. The invalidity of any provision of this Lease, as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

19. INTEREST ON PAST-DUE OBLIGATIONS. Any monetary payment due Lessor hereunder, other than late charges, not received by Lessor within ten (10) days following the date on which it was due, shall bear interest from the date due at the prime rate of 10% per annum in addition to the potential late charge provided for in Paragraph 13.4.

20. TIME OF ESSENCE. Time is of the essence with respect to the performance of all obligations to be performed or observed by the Parties under this Lease.

21. RENT DEFINED. All monetary obligations of Lessee to Lessor under the terms of this Lease are deemed to be rent.

22. NO PRIOR OR OTHER AGREEMENTS. This Lease contains all agreements between the Parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective. Lessor and Lessee each represents and warrants to the Brokers that it has made, and is relying solely upon, its own investigation as to the nature, quality, character and financial responsibility of the other party to this Lease and as to the nature, quality and character of the Premises. See Paragraph 56.

#### 23. NOTICES.

23.1 NOTICE REQUIREMENTS. All notices required or permitted by this Lease shall be in writing and may be delivered in person (by hand or by messenger or courier service) or may be sent by regular, certified or registered mail or U.S. Postal Service Express Mail, with postage prepaid, or by facsimile transmission during normal business hours, and shall be deemed sufficiently given if served in a manner specified in this Paragraph 23. The addresses noted adjacent to a Party's signature on this Lease shall be that Party's address for delivery or

mailing of notice purposes. Either Party may by written notice to the other specify a different address for notice purposes, except that upon Lessee's taking possession of the Premises, the Premises shall constitute Lessee's address for the purpose of mailing or delivering notices to Lessee. A copy of all notices required or permitted to be given to lessor hereunder shall be concurrently transmitted to such party or parties at such addresses as Lessor may from time to time hereafter designate by written notice to Lessee.

23.2 DATE OF NOTICE. Any notice sent by registered or certified mail, return receipt requested, shall be deemed given on the date of delivery shown on the receipt card, or if no delivery date is shown, the postmark thereon. If sent by regular mail, the notice shall be deemed given forty-eight (48) hours after the same is addressed as required herein and mailed with postage prepaid. Notices delivered by United States Express Mail or overnight courier that guarantees next day

delivery shall be deemed given twenty-four (24) hours after delivery of the same to the United States Postal Service or courier. If any notice is transmitted by facsimile transmission or similar means, the same shall be deemed served or delivered upon telephone or facsimile confirmation of receipt of the transmission thereof, provided a copy is also delivered via delivery or mail. If notice is received on a Saturday or a Sunday or a legal holiday, it shall be deemed received on the next business day.

24. WAIVERS. No waiver by Lessor of the Default or Breach of any term, covenant or condition hereof by Lessee, shall be deemed a waiver of any other term, covenant or condition hereof, or of any subsequent Default or Breach by Lessee of the same or any other term, covenant or condition hereof. Lessor's consent to, or approval of, any such act shall not be deemed to render unnecessary the obtaining of Lessor's consent to, or approval of, any subsequent or similar act by Lessee, or be construed as the basis of an estoppel to enforce the provision or provisions of this Lease requiring such consent. Regardless of Lessor's knowledge of a Default or Breach at the time of accepting rent, the acceptance of rent by Lessor shall not be a waiver of any Default or Breach by Lessee of any provision hereof. Any payment given Lessor by Lessee may be accepted by Lessor on account of moneys or damages due Lessor, notwithstanding any qualifying statements or conditions made by Lessee in connection therewith, which such statements and/or conditions shall be of no force or effect whatsoever unless specifically agreed to in writing by Lessor at or before the time of deposit of such payment.

25. RECORDING. Either Lessor or Lessee shall, upon request of the other, execute, acknowledge and deliver to the other a short form memorandum of this Lease for recording purposes. The Party requesting recordation shall be responsible for payment of any fees or taxes applicable thereto.

26. NO RIGHT TO HOLDOVER. Lessee has no right to retain possession of the Premises or any part thereof beyond the expiration or earlier termination of this Lease. In the event that Lessee holds over in violation of this Paragraph 26 then the Base Rent payable from and after the time of the expiration or earlier termination of this Lease shall be increased to two hundred percent (200%) of the Base Rent applicable during the month immediately preceding such expiration or earlier termination. Nothing contained herein shall be construed as a consent by Lessor to any holding over by Lessee.

27. CUMULATIVE REMEDIES. No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at law or in equity.

28. COVENANTS AND CONDITIONS. All provisions of this Lease to be observed or performed by Lessee are both covenants and conditions.

29. BINDING EFFECT; CHOICE OF LAW. This Lease shall be binding upon the Parties, their personal representatives, successors and assigns and be governed by the laws of the State in which the Premises are located. Any litigation between the Parties hereto concerning this Lease shall be initiated in the county in which the Premises are located.

30. SUBORDINATION; ATTORNMEN; NON-DISTURBANCE.

30.1 SUBORDINATION. This Lease and any Option granted hereby shall be subject and subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively, "SECURITY DEVICE"), now or

hereafter placed by Lessor upon the real property of which the Premises are a part, to any and all advances made on the security thereof, and to all renewals, modifications, consolidations, replacements and extensions thereof. Lessee agrees that the Lenders holding any such Security Device shall have no duty, liability or obligation to perform any of the obligations of Lessor under this Lease, but that in the event of Lessor's default with respect to any such obligation, Lessee will give any Lender whose name and address have been furnished Lessee in writing for such purpose notice of Lessor's default pursuant to Paragraph 13.5. If any Lender shall elect to have this Lease and/or any Option granted hereby superior to the lien of its Security Device and shall give written notice thereof to Lessee, this Lease and such Options shall be deemed prior to such Security Device, notwithstanding the relative dates of the documentation or recordation thereof.

30.2 ATTORNMENT. Subject to the non-disturbance provision of Paragraph 30.3, Lessee agrees to attorn to a Lender or any other party who acquires ownership of the Premises by reason of a foreclosure of a Security Device, and that in the event of such foreclosure, such new owner shall not: (i) be liable for any act or omission of any prior lessor or with respect to events occurring prior to acquisition of ownership, (ii) be subject to any offsets or defenses which Lessee might have against any prior lessor, or (iii) be bound by prepayment of more than one month's rent.

30.3 NON-DISTURBANCE. With respect to Security Devices entered into by Lessor after execution of this lease, Lessee's subordination of this Lease shall be subject to receiving assurance (a "non-disturbance agreement") from the Lender that Lessee's possession and this Lease, including any options to extend the term hereof, will not be disturbed so long as Lessee is not in Breach hereof and attorns to the record owner of the Premises.

30.4 SELF-EXECUTING. The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents; provided, however, that upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of Premises, Lessee and Lessor shall execute such further writings as may be reasonably required to separately document any such subordination or non-subordination, attornment and/or non-disturbance agreement as is provided for herein.

31. ATTORNEYS' FEES. If any Party or Broker brings an action or proceeding to enforce the terms hereof or declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorneys' fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term "PREVAILING PARTY" shall include, without limitation, a Party or Broker who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party or Broker of its claim or defense. The attorneys' fee award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. Lessor shall be entitled attorneys' fees, costs and expenses incurred in preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach. Broker(s) shall be intended third party beneficiaries of this Paragraph 31.

32. LESSOR'S ACCESS: SHOWING PREMISES; REPAIRS. Lessor and Lessor's agents shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times for the purpose of showing the same to prospective purchasers, lenders, or lessees, and making such alterations, repairs, improvements or additions to the Premises or to the Building, as Lessor may reasonably deem necessary. Lessor may at any time place on or about the Premises or Building any ordinary "For Sale" signs and Lessor may at any time during the last one hundred eighty (180) days of the term hereof place on or about the Premises any ordinary "For Lease" signs. All such activities of Lessor shall be without abatement of rent or liability to Lessee.

33. AUCTIONS. Lessee shall not conduct, nor permit to be conducted, either voluntarily or involuntarily, any auction upon the Premises without first having obtained Lessor's prior written consent. Notwithstanding anything to the contrary in this Lease, Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to grant such consent.

34. SIGNS. Lessee shall not place any sign upon the exterior of the Premises

or the Building, except that Lessee may, with Lessor's prior written consent, install (but not on the roof) such signs as are reasonably required to advertise Lessee's own business so long as such signs are in a location designated by Lessor and comply with Applicable Requirements and the signage criteria established for the industrial Center by Lessor. The installation of any sign on the Premises by or for Lessee shall be subject to the provisions of Paragraph 7 (Maintenance, Repairs, Utility Installations, Trade Fixtures and Alterations). Unless otherwise expressly agreed herein, Lessor reserves all rights to the use of the roof of the Building, and the right to install advertising signs on the Building, including the roof, which do not unreasonably interfere with the conduct of Lessee's business; Lessor shall be entitled to all revenues from such advertising signs: See Paragraph 57

35. TERMINATION; MERGER. Unless specifically stated otherwise in writing by Lessor, the voluntary or other surrender of this Lease by Lessee, the mutual termination or cancellation hereof, or a termination hereof by Lessor for Breach by Lessee, shall automatically terminate any sublease or lesser estate in the Premises: provided, however, Lessor shall, in the event of any such surrender, termination or cancellation, have the option to continue any one or all of any existing subtenancies. Lessor's failure within ten (10) days following any such event to make a written election to the contrary by written notice to the holder of any such lesser interest, shall constitute Lessor's election to have such event constitute the termination of such interest.

36. CONSENTS.

(a) Except for Paragraph 33 hereof (Auctions) or as otherwise provided herein, wherever in this Lease the consent of a Party is required to an act by or for the other Party, such consent shall not be unreasonably withheld or delayed. Lessor's actual reasonable costs and expenses (including but not limited to architects', attorneys', engineers' and other consultants' fees) incurred in the consideration of, or response to, a request by Lessee for any Lessor consent pertaining to this Lease or the Premises, including but not limited to consents to an assignment a subletting or the presence or use of a Hazardous Substance, shall be paid by Lessee to Lessor upon receipt of an invoice and supporting documentation therefor. In addition to the deposit described in Paragraph 12.2(e), Lessor may, as a condition to considering any such request by Lessee, require that Lessee deposit with Lessor an amount of money (in addition to the Security Deposit held under Paragraph 5) reasonably calculated by Lessor to represent the cost Lessor will incur in considering and responding to Lessee's request. Any unused portion of said deposit shall be refunded to Lessee without interest. Lessor's consent to any act, assignment of this Lease or subletting of the Premises by Lessee shall not constitute an acknowledgment that no Default or Breach by Lessee of this Lease exists, nor shall such consent be deemed a waiver of any then existing Default or Breach, except as may be otherwise specifically stated in writing by Lessor at the time of such consent.

(b) All conditions to Lessor's consent authorized by this Lease are acknowledged by Lessee as being reasonable. The failure to specify herein any particular condition to Lessor's consent shall not preclude the impositions by Lessor at the time of consent of such further or other conditions as are then reasonable with reference to the particular matter for which consent is being given.

38. QUIET POSSESSION. Upon payment by Lessee of the rent for the Premises and the performance of all of the covenants, conditions and provisions on Lessee's part to be observed and performed under this Lease, Lessee shall have quiet possession of the Premises for the entire term hereof subject to all of the provisions of this Lease.

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39. OPTIONS.

39.1 DEFINITION. As used in this Lease, the word "OPTION" has the following meaning: (a) the right to extend the term of this Lease or to renew this Lease.

39.2 OPTIONS PERSONAL TO ORIGINAL LESSEE. Each Option granted to Lessee in this Lease is personal to the original Lessee named in Paragraph 1.1 hereof, and cannot be voluntarily or involuntarily assigned or exercised by any person or entity other than said original Lessee while the original Lessee is in full and actual possession of the Premises and without the intention of thereafter assigning or subletting. The Options, if any, herein granted to Lessee are not



assignable, either as part of an assignment of this Lease or separately or apart therefrom, and no Option may be separated from this Lease in any manner, by reservation or otherwise.

39.3 MULTIPLE OPTIONS. In the event that Lessee has any multiple Options to extend or renew this Lease, a later option cannot be exercised unless the prior Options to extend or renew this Lease have been validly exercised.

39.4 EFFECT OF DEFAULT ON OPTIONS.

(a) Lessee shall have no right to exercise an Option, notwithstanding any provision in the grant of Option to the contrary: (i) during the period commencing with the giving of any notice of Default under Paragraph 13.1 and continuing until the noticed Default is cured, or (ii) during the period of time any monetary obligation due Lessor from Lessee is unpaid (without regard to whether notice thereof is given Lessee), or (iii) during the time Lessee is in Breach of this Lease, or (iv) in the event that Lessor has given to Lessee three (3) or more notices of separate Defaults under Paragraph 13.1 during the twelve (12) month period immediately preceding the exercise of the Option, whether or not the Defaults are cured.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 39.4(a).

(c) All rights of Lessee under the provisions of an Option shall terminate and be of no further force or effect, notwithstanding Lessee's due and timely exercise of the Option, if, after such exercise and during the term of this Lease, (i) Lessee fails to pay to Lessor a monetary obligation of Lessee for a period of thirty (30) days after such obligation becomes due (without any necessity of Lessor to give notice thereof to Lessee), or (ii) Lessor gives to Lessee three (3) or more notices of separate Defaults under Paragraph 13.1 during any twelve (12) month period, whether or not the Defaults are cured, or (iii) if Lessee commits a Breach of this Lease.

40. RULES AND REGULATIONS. Lessee agrees that it will abide by, and keep and observe all reasonable rules and regulations ("RULES AND REGULATIONS") which Lessor may make from time to time for the management, safety, care, and cleanliness of the grounds, the parking and unloading of vehicles and the preservation of good order, as well as for the convenience of other occupants or tenants of the Building and the Industrial Center and their invitees.

41. SECURITY MEASURES. Lessee hereby acknowledges that the rental payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of the Premises, Lessee, its agents and invitees and their property from the acts of third parties.

42. RESERVATIONS. Lessor reserves the right, from time to time, to grant, without the consent or joinder of Lessee, such easements, rights of way, utility raceways, and dedications that Lessor deems necessary, and to cause the recordation of parcel maps and restrictions, so long as such easements, rights of way, utility raceways, dedications, maps and restrictions do not reasonably interfere with the use of the premises by Lessee. Lessee agrees to sign any documents reasonably requested by Lessor to effectuate any such easement rights, dedication, map or restrictions.

43. PERFORMANCE UNDER PROTEST. If at any time a dispute shall arise as to any amount or sum of money to be paid by one Party to the other under the provisions hereof, the Party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment and there shall survive the right on the part of said Party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said Party to pay such sum or any part thereof, said Party shall be entitled to recover such sum or so much thereof as it was not legally required to pay under the provisions of this Lease.

44. AUTHORITY. If either Party hereto is a corporation, trust, or general or limited partnership, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on its behalf. If Lessee is a corporation, trust, or partnership, Lessee shall, within thirty (30) days after request by Lessor,



Title: Owner Title: Director of Real Estate  
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By: /s/ DONNA PIAZZA By:  
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Name Printed: Donna Piazza, Trustee Name Printed:  
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Title: Owner Title:  
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Address: 2612 Pine Address:  
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Manhattan Beach, CA 90266  
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Telephone: (310) 545-4203 Telephone: ( )  
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Facsimile: ( ) Facsimile: ( )

BROKER: BROKER:  
Executed at: Executed at:

on: on:

By: By:

Name Printed: Name Printed:

Title: Title:

Address: Address:

Telephone: ( ) Telephone: ( )

Facsimile: ( ) Facsimile: ( )

</TABLE>  
NOTE: These forms are often modified to meet changing requirements of law and needs of the industry. Always write or call to make sure you are utilizing the most current form: AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION, 345 So. Figueroa St., M-1, Los Angeles, CA 90071. (213) 687-8777.

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ADDENDUM TO STANDARD INDUSTRIAL/COMMERCIAL  
MULTI-TENANT LEASE - MODIFIED NET  
BY AND BETWEEN RICHARD AND DONNA PIAZZA,  
TRUSTEES OF THE PIAZZA FAMILY TRUST and  
SKECHERS U.S.A., INC. ("LESSEE")

This Addendum is attached to and made a part of the Lease dated as of June 12, 1998 by and between the above-named Lessor and Lessee, with regard to the leased premises located at 1112 Manhattan Avenue, Manhattan Beach, California. In the event of a conflict between any provision(s) contained in the Lease and any provision(s) contained in this Addendum, the provisions of this Addendum shall control.

49. Option to Extend. So long as Lessee is not in default under this Lease, or the lease for the Upstairs Space (as defined in Paragraph 56), or the right of Lessor to exercise the option to extend this Lease as set forth below is not precluded by the occurrence of one (1) or more of the events set forth in Paragraph 39.4 of the Lease, Lessee will have the option to extend the Original Term of this Lease for an additional period of five (5) years ("Option Period")

on the same terms, covenants and conditions of this Lease, except that the Base Rent during the Option Period shall be determined pursuant to Paragraph 50. Lessee will exercise its option by giving Lessor written notice at least one hundred eighty (180) days but not more than two hundred seventy days (270) days prior to the expiration of the Original Term.

50. Rent Increases. Commencing June 14, 1999 and on each June 14 thereafter during the Original Term hereof and the Option Period, the Base Rent shall be increased by four percent (4%) of the Base Rent payable during the prior twelve (12) months.

51. Base Rent Upon Execution. The \$8,487.00 payment upon execution of this Lease represents Base Rent for June 15 through June 30, 1998 and the entire month of July 1998.

52. As-Is Condition. Lessor shall deliver the Premises to Lessee, and Lessee shall lease from Lessor the Premises in its "as-is" condition as of the Commencement Date. Lessee shall have no obligation to construct any additional improvements to the Premises, or to repair or clean up any portion of the Premises.

53. Exclusions from Common Area Operating Expenses. Notwithstanding anything to the contrary contained in the Lease, there shall be excluded from Common Area Operating Expenses the following:

(1) Costs incurred in connection with the original construction of the Industrial Center or in connection with any major change in the Industrial Center, such as adding or deleting floors;

(2) Costs of alterations or improvements to the premises of any lessees of the Building;

(3) Depreciation, interest and principal payments on mortgages, and other debt costs, if any;

(4) Costs for which Lessor is reimbursed by any insurance carrier;

(5) Any bad debt loss, rent loss or reserves for bad debts or rent loss;

(6) Fines, penalties and interest (except as specifically provided in paragraph 19 or this Lease); and

(7) Tax penalties incurred as a result of Lessor's negligence, inability or unwillingness to make payments when due.

In the calculation of Common Area Operating Expenses, it is understood that no expenses shall be charged more than once. If one lessee's use results in higher insurance premiums on the policies maintained by Lessor hereunder, Lessor agrees to provide an equitable proration thereof in billing the Common Area Operating Expenses. Lessor agrees to keep books and records showing the Common Area Operating Expenses in accordance with a system of accounts and account practices consistently maintained on a year-to-year basis, and to provide Lessee with access thereto upon reasonable notice.

54. Notwithstanding any other provision of the Lease or this Addendum, Lessee acknowledges that the retail businesses at the Building engage in the practice of displaying merchandise in the Common Area in front of their respective premises. Lessee further acknowledges that the other lessees' display of their merchandise in the Common Area shall be an acceptable use of the Common Area by other lessee's of the Building and shall not be a breach of Lessor's obligation to operate the Common Area in a neat, clean, good order and condition.

55. Assignment. Notwithstanding the provisions of paragraph 12, no consent form Lessor shall be required for the assignment or subletting of this lease under the following circumstances:

(i) the transfer of stock of Lessee to members of immediate family of a shareholder of Lessee, to a living trust for estate-planning purposes, or by will or intestacy; or

(ii) Lessee sells or offers for sale its voting stock to the public in accordance with the qualifications or registration requirements of the State of California and the Security Act of 1933, as amended.

56. Notwithstanding the foregoing, Lessor and Lessee acknowledge that the parties have entered into a separate Commercial Lease Agreement for that certain portion of the Building commonly known as 1110 Manhattan Avenue, Manhattan Beach, CA ("Upstairs Space").

57. Lessee's Sign. In addition to the obligations of Lessee with respect to the placement of a sign upon the exterior of the Premises ("Lessee's Sign") and Lessee's adherence to the signage criteria established for the Building by Lessor, Lessee's Sign shall conform with the signs of the other retail lessees at the Building.

58. Upstairs Electrical Work. Lessee acknowledges that certain electrical work in the amount of \$5,826.00 was performed by an electrical contractor on behalf of Lessor in the Upstairs Space ("Upstairs Electrical Work"). Lessee paid the electrical contractor directly for the Upstairs Electrical Work. Though payment for the Upstairs Electrical Work was the responsibility of Lessor, Lessee forever releases and discharges Lessor and its successors and assigns from any claim for reimbursement which Lessee has against Lessor for reimbursement which Lessee has against Lessor for the Upstairs Electrical Work.

59. Restaurant Improvements. Lessee acknowledges that prior to the Commencement Date, Lessor has constructed substantial improvements in the Premises in order to accommodate a restaurant operator ("Restaurant Improvements"). Lessee shall not during the course of the construction of its Lessee Owned Alterations and/or Utility Installations in the Premises or at any time during the Original Term or Option Period, remove, replace, modify or disturb any of the Restaurant Improvements.

60. Lease Preparation Legal Fees. Lessee acknowledges that Lessor incurred certain legal fees in engaging the law firm of Baker, Burton & Lundy ("BB&L") to prepare a draft of a lease for the Premises ("Draft Lease"). Lessee acknowledges that Lessee shall be responsible for and pay directly to BB&L those specific legal fees incurred by Lessor in connection with the preparation of the Draft Lease, and Lessee forever releases and discharges Lessor and its successors and assigns from any claim for reimbursement for such legal fees paid by Lessee to BB&L with respect to the Draft Lease.

STANDARD INDUSTRIAL/COMMERCIAL MULTI-TENANT LEASE -- MODIFIED NET  
AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION

[LOGO]

1. BASIC PROVISIONS ("BASIC PROVISIONS").

1.1 PARTIES: This Lease ("LEASE"), dated for reference purposes only, June 12, 1998, is made by and between Richard and Donna Piazza, Trustees of the Piazza Family Trust ("LESSOR") and Skechers U.S.A., Inc. ("LESSEE"), (collectively the "PARTIES," or individually a "PARTY").

1.2(a) PREMISES: That certain portion of the Building, including all improvements therein or to be provided by Lessor under the terms of this Lease, commonly known by the street address of 1112 Manhattan Ave., located in the City of Manhattan Beach, County of Los Angeles, State of California, with zip code 90266, as outlined on Exhibit \_\_ attached hereto ("PREMISES"). The "BUILDING" is that certain building containing the Premises and generally described as (describe briefly the nature of the Building): 1108-1112 Manhattan Avenue, Manhattan Beach. In addition to Lessee's rights to use and occupy the Premises as hereinafter specified, Lessee shall have non-exclusive rights to the Common Areas (as defined in Paragraph 2.7 below) as hereinafter specified, but shall not have any rights to the roof, exterior walls or utility raceways of the Building or to any other buildings in the Industrial Center. The Premises, the Building, the Common Areas, the land upon which they are located, along with all other buildings and improvements thereon, are herein collectively referred to as the "INDUSTRIAL CENTER." (Also see Paragraph 2.)

1.2(b) PARKING: None unreserved vehicle parking spaces ("UNRESERVED PARKING SPACES"); and None reserved vehicle parking spaces ("RESERVED PARKING SPACES"). (Also see Paragraph 2.6.)

1.3 TERM: 3 years and 8 1/2 months ("ORIGINAL TERM") commencing June 15, 1998 ("COMMENCEMENT DATE") and ending February 28, 2002 ("EXPIRATION DATE"). (Also see Paragraph 3.) See Paragraph 49.

1.4 EARLY POSSESSION: None ("EARLY POSSESSION DATE"). (Also see Paragraphs 3.2 and 3.3.)

1.5 BASE RENT: \$5,658.00 per month ("BASE RENT"), payable on the first day of each month commencing July 1, 1998 (Also see Paragraph 4.)

If this box is checked, this Lease provides for the Base Rent to be adjusted per Addendum 50, attached hereto. See Paragraph 50.

1.6(a) BASE RENT PAID UPON EXECUTION: \$8,487.00 Base Rent for the period Commencement date through July 31, 1998. See Paragraph ??.

1.6(b) LESSEE'S SHARE OF COMMON AREA OPERATING EXPENSES: Twenty-one percent (21%) ("LESSEE'S SHARE") as determined by  prorata square footage of the Premises as compared to the total square footage of the Building or  other criteria as described in Addendum \_\_\_\_.

1.7 SECURITY DEPOSIT: \$5,658.00 ("SECURITY DEPOSIT"). (Also see Paragraph 5.)

1.8 PERMITTED USE: General office use and no other purpose ("PERMITTED USE") (Also see Paragraph 6.)

1.9 INSURING PARTY. Lessor is the "INSURING PARTY." (Also see Paragraph 8.)

1.10(a) REAL ESTATE BROKERS. The following real estate broker(s) (collectively, the "Brokers") and brokerage relationships exist in this transaction and are consented to by the Parties (check applicable boxes):

N/A represents Lessor exclusively ("LESSOR'S BROKER");

N/A represents Lessee exclusively ("LESSEE'S BROKER"); or

[ ] N/A represents both Lessor and Lessee ("DUAL AGENCY"). (Also see Paragraph 15.)

1.10(b) PAYMENT TO BROKERS. Upon the execution of this Lease by both Parties, Lessor shall pay to said Broker(s) jointly, or in such separate shares as they may mutually designate in writing, a fee as set forth in a separate written agreement between Lessor and said Broker(s) (or in the event there is no separate written agreement between Lessor and Broker(s), the sum of \$0) for brokerage services rendered by said Broker(s) in connection with this transaction.

1.11 GUARANTOR: The obligations of the Lessee under this Lease are to be guaranteed by NONE ("Guarantor"). (Also see Paragraph 37.)

1.12 ADDENDA AND EXHIBITS. Attached hereto is an Addendum or Addenda consisting of Paragraphs 49 through 60, and Exhibits \_\_\_ through \_\_\_, all of which constitute a part of this Lease.

## 2. PREMISES, PARKING AND COMMON AREAS.

2.1 LETTING. Lessor hereby leases to Lessee, and Lessee hereby leases from Lessor, the Premises, for the term, at the rental, and upon all of the terms, covenants and conditions set forth in this Lease. Unless otherwise provided herein, any statement of square footage set forth in this Lease, or that may have been used in calculating rental and/or Common Area Operating Expenses, is an approximation which Lessor and Lessee agree is reasonable and the rental and Lessee's Share (as defined in Paragraph 1.6(b)) based thereon is not subject to revision whether or not the actual square footage is more or less.

See Paragraph 52.

### 2.2 CONDITION.

2.4 ACCEPTANCE OF PREMISES. Lessee hereby acknowledges: (a) that it has been advised by the Broker(s) to satisfy itself with respect to the condition of the Premises (including but not limited to the electrical and fire sprinkler systems, security, environmental aspects, seismic and earthquake requirements, and compliance with the Americans with Disabilities Act and applicable zoning, municipal, county, state and federal laws, ordinances and regulations and any covenants or restrictions of record (collectively, "APPLICABLE LAWS") and the present and future suitability of the Premises for Lessee's intended use; (b) that Lessee has made such investigation as it deems necessary with reference to such matters, is satisfied with reference thereto, and assumes all responsibility therefore as the same relate to Lessee's occupancy of the Premises and/or the terms of this Lease; and (c) that neither Lessor, nor any of Lessor's agents, has made any oral or written representations or warranties with respect to said matters other than as set forth in this Lease.

2.5 LESSEE AS PRIOR OWNER/OCCUPANT. The warranties made by Lessor in this Paragraph 2 shall be of no force or effect if immediately prior to the date set forth in Paragraph 1.1 Lessee was the owner or occupant of the Premises. In such event, Lessee shall, at Lessee's sole cost and expense, correct any non-compliance of the Premises with said warranties.

Initials: DP

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MULTI-TENANT--MODIFIED NET

RAM

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2.7 COMMON AREAS - DEFINITION. The term "COMMON AREAS" is defined as all areas and facilities outside the Premises and within the exterior boundary line of the Industrial Center and interior utility raceways within the Premises that are provided and designated by the Lessor from time to time for the general non-exclusive use of Lessor, Lessee and other lessees of the Industrial Center and their respective employees, suppliers, shippers, customers, contractors and invitees, including parking areas, loading and unloading areas, trash areas, roadways, sidewalks, walkways, parkways, driveways and landscaped areas.

2.8 COMMON AREAS - LESSEE'S RIGHTS. Lessor hereby grants to Lessee, for the benefit of Lessee and its employees, suppliers, shippers, contractors, customers and invitees, during the term of this Lease, the non-exclusive right to use, in common with others entitled to such use, the Common Areas as they exist from time to time, subject to any rights, powers, and privileges reserved by Lessor under the terms hereof or under the terms of any rules and regulations or restrictions governing the use of the Industrial Center. Under no circumstances shall the right herein granted to use the Common Areas be deemed to include the right to store any property, temporarily or permanently, in the Common Areas. Any such storage shall be permitted only by the prior written consent of Lessor or Lessor's designated agent, which consent may be revoked at any time. In the event that any unauthorized storage shall occur then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove the property and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor.

2.9 COMMON AREAS - RULES AND REGULATIONS. Lessor or such other person(s) as Lessor may appoint shall have the exclusive control and management of the Common Areas and shall have the right, from time to time, to establish, modify, amend and enforce reasonable Rules and Regulations with respect thereto in accordance with Paragraph 40. Lessee agrees to abide by and conform to all such Rules and Regulations, and to cause its employees, suppliers, shippers, customers, contractors and invitees to so abide and conform. Lessor shall not be responsible to Lessee for the non-compliance with said rules and regulations by other lessees of the Industrial Center.

2.10 COMMON AREAS - CHANGES. Lessor shall have the right, in Lessor's sole discretion, from time to time:

(a) To make changes to the Common Areas, including, without limitation, changes in the location, size, shape and number of driveways, entrances, parking spaces, parking areas, loading and unloading areas, ingress, egress, direction of traffic, landscaped areas, walkways and utility raceways;

(b) To close temporarily any of the Common Areas for maintenance purposes so long as reasonable access to the Premises remains available;

(c) To designate other land outside the boundaries of the Industrial Center to be a part of the Common Areas;

(d) To add additional buildings and improvements to the Common Areas;

(e) To use the Common Areas while engaged in making additional improvements, repairs or alterations to the Industrial Center, or any portion thereof; and

(f) To do and perform such other acts and make such other changes in, to or with respect to the Common Areas and Industrial Center as Lessor may, in the exercise of sound business judgment, deem to be appropriate.

### 3. TERM.

3.1 TERM. The Commencement Date, Expiration Date and Original Term of this Lease are as specified in Paragraph 1.3.

### 4. RENT.

4.1 BASE RENT. Lessee shall pay Base Rent and other rent or charges, as the same may be adjusted from time to time, to Lessor in lawful money of the United States, without offset or deduction, on or before the day on which it is due under the terms of this Lease. Base Rent and all other rent and charges for any period during the term hereof which is for less than one full month shall be prorated based upon the actual number of days of the month involved. Payment of Base Rent and other charges shall be made to Lessor at its address stated herein or to such other persons or at such other addresses as Lessor may from time to time designate in writing to Lessee.

4.2 COMMON AREA OPERATING EXPENSES. Lessee shall pay to Lessor during the term hereof, in addition to the Base Rent, Lessee's Share (as specified in Paragraph 1.6(b)) of all Common Area Operating Expenses, as



hereinafter defined, during each calendar year of the term of this Lease, in accordance with the following provisions:

(a) "COMMON AREA OPERATING EXPENSES" are defined, for purposes of this Lease, as all costs incurred by Lessor relating to the ownership and operation of the Industrial Center, including, but not limited to, the following:

(i) The operation, repair and maintenance, in neat, clean, good order and condition, of the following:

(aa) The Common Areas, including parking areas, loading and unloading areas, trash areas, roadways, sidewalks, walkways, parkways, driveways, landscaped areas, striping, bumpers, irrigation systems, Common Area lighting facilities, fences and gates, elevators and roof.

(bb) Exterior signs and any tenant directories.

(cc) Fire detection and sprinkler systems.

(ii) The cost of water, gas, electricity and telephone to service the Common Areas.

(iii) Trash disposal, property management and security services and the costs of any environmental inspections.

(v) Real Property Taxes (as defined in Paragraph 10.2) to be paid by Lessor for the Building and the Common Areas under Paragraph 10 hereof.

(vi) The cost of the premiums for the insurance policies maintained by Lessor under Paragraph 8 hereof.

(vii) Any deductible portion of an insured loss concerning the Building or the Common Areas.

(viii) Any other services to be provided by Lessor that are stated elsewhere in this Lease to be a Common Area Operating Expense.

(b) Any Common Area Operating Expenses and Real Property Taxes that are specifically attributable to the Building or to any other building in the Industrial Center or to the operation, repair and maintenance thereof, shall be allocated entirely to the Building or to such other building. However, any Common Area Operating Expenses and Real Property Taxes that are not specifically attributable to the Building or to any other building or to the operation, repair and maintenance thereof, shall be equitably allocated by Lessor to all buildings in the Industrial Center.

(c) The inclusion of the improvements, facilities and services set forth in Subparagraph 4.2(a) shall not be deemed to impose an obligation upon Lessor to either have said improvements or facilities or to provide those services unless the Industrial Center already has the same, Lessor already provides the services, or Lessor has agreed elsewhere in this Lease to provide the same or some of them.

(d) Lessee's Share of Common Area Operating Expenses shall be payable by Lessee within ten (10) days after a reasonably detailed statement of actual expenses is presented to Lessee by Lessor. At Lessor's option, however, an amount may be estimated by Lessor from time to time of Lessee's Share of annual Common Area Operating Expenses and the same shall be payable monthly or quarterly, as Lessor shall designate, during each 12-month period of the Lease term, on the same day as the Base Rent is due hereunder. Lessor shall deliver to Lessee within sixty (60) days after the expiration of each calendar year a reasonably detailed statement showing Lessee's Share of the actual Common Area Operating Expenses incurred during the preceding year. If Lessee's payments under this Paragraph 4.2(d) during said preceding year exceed Lessee's Share as indicated on said statement, Lessee shall be credited the amount of such over-

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payment against Lessee's Share of Common Area Operating Expenses next becoming due. If Lessee's payments under this Paragraph 4.2(d) during said preceding year were less than Lessee's Share as indicated on said statement, Lessee shall pay to Lessor the amount of the deficiency within ten (10) days after delivery by Lessor to Lessee of said statement. See Sections 53 and 54.

5. SECURITY DEPOSIT. Lessee shall deposit with Lessor upon Lessee's execution hereof the Security Deposit set forth in Paragraph 1.7 as security for Lessee's faithful performance of Lessee's obligations under this Lease. If Lessee fails to pay Base Rent or other rent or charges due hereunder, or otherwise Defaults under this Lease (as defined in Paragraph 13.1), Lessor may use, apply or retain all or any portion of said Security Deposit for the payments of any amount due Lessor or to reimburse or compensate Lessor for any liability, cost, expense, loss or damage (including attorneys' fees) which Lessor may suffer or incur by reason thereof. If Lessor uses or applies all or any portion of said Security Deposit, Lessee shall within ten (10) days after written request therefore deposit monies with Lessor sufficient to restore said Security Deposit to the full amount required by this Lease. Any time the base rent increases during the term of this Lease, Lessee shall, upon written request from Lessor, deposit additional monies with Lessor as an addition to the Security Deposit so that the total amount of the Security Deposit shall at all times bear the same proportion to the then current Base Rent as the initial Security Deposit bears to the initial Base Rent set forth in Paragraph 1.5. Lessor shall not be required to keep all or any part of the Security Deposit separate from its general accounts. Lessor shall, at the expiration or earlier termination of the term hereof and after Lessee has vacated the Premises, return to Lessee (or, at Lessor's option, to the last assignee, if any, of Lessee's interest herein), that portion of the Security Deposit not used or applied by Lessor. Unless otherwise expressly agreed in writing by Lessor, no part of the Security Deposit shall be considered to be held in trust, to bear interest or other increment for its use, or to be prepayment for any monies to be paid by Lessee under this Lease.

6. USE.

6.1 PERMITTED USE.

(a) Lessee shall use and occupy the Premises only for the Permitted Use set forth in Paragraph 1.8, and for no other purpose. Lessee shall not use or permit the use of the Premises in a manner that is unlawful, creates waste or a nuisance, or that disturbs owners and/or occupants of, or causes damage to the Premises or neighboring premises or properties.

6.2 HAZARDOUS SUBSTANCES.

(a) REPORTABLE USES REQUIRE CONSENT. The term "Hazardous Substance" as used in this Lease shall mean any product, substance, chemical, material or waste whose presence, nature, quantity and/or intensity of existence, use, manufacture, disposal, transportation, spill, release or effect, either by itself or in combination with other materials expected to be on the Premises, is either: (i) potentially injurious to the public health, safety or welfare, the environment, or the Premises; (ii) regulated or monitored by any governmental authority; or (iii) a basis for potential liability of Lessor to any governmental agency or third party under any applicable statute or common law theory. Hazardous Substance shall include, but not be limited to, hydrocarbons, petroleum, gasoline, crude oil or any products or by-products thereof. Lessee shall not engage in any activity in or about the Premises which constitutes a Reportable Use (as hereinafter defined) of Hazardous Substances without the express prior written consent of Lessor and compliance in a timely manner (at Lessee's sole cost and expense) with all Applicable Requirements (as defined in Paragraph 6.3). "Reportable Use" shall mean (i) the installation or use of any above or below ground storage tank, (ii) the generation, possession, storage, use, transportation, or disposal of a Hazardous Substance that requires a permit from, or with respect to which a report, notice, registration or business plan is required to be filed with, any governmental authority, and (iii) the presence in, on or about the Premises of a Hazardous Substance with respect to which any Applicable Laws require that a notice be given to persons entering or occupying the Premises or neighboring properties. Notwithstanding the foregoing, Lessee may, without Lessor's prior consent, but upon notice to

Lessor and in compliance with all Applicable Requirements, use any ordinary and customary materials reasonably required to be used by Lessee in the normal course of the Permitted Use, so long as such use is not a Reportable Use and does not expose the Premises or neighboring properties to any meaningful risk of contamination or damage or expose Lessor to any liability therefor. In addition, Lessor may (but without any obligation to do so) condition its consent to any Reportable Use of any Hazardous Substance by Lessee upon Lessee's giving Lessor such additional assurances as Lessor, in its reasonable discretion, deems necessary to protect itself, the public, the Premises and the environment against damage, contamination or injury and/or liability therefor, including but not limited to the installation (and, at Lessor's option, removal on or before Lease expiration or earlier termination) of reasonably necessary protective modifications to the Premises (such as concrete encasements) and/or the deposit of an additional Security Deposit under Paragraph 5 hereof.

(b) DUTY TO INFORM LESSOR. If Lessee knows, or has reasonable cause to believe, that a Hazardous Substance has come to be located in, on, under or about the Premises or the Building, other than as previously consented to by Lessor, Lessee shall immediately give Lessor written notice thereof, together with a copy of any statement, report, notice, registration, application, permit, business plan, license, claim, action, or proceeding given to, or received from, any governmental authority or private party concerning the presence, spill, release, discharge of, or exposure to, such Hazardous Substance including but not limited to all such documents as may be involved in any Reportable Use involving the Premises. Lessee shall not cause or permit any Hazardous Substance to be spilled or released in, on, under or about the Premises (including, without limitation, through the plumbing or sanitary sewer system).

(c) INDEMNIFICATION. Lessee shall indemnify, protect, defend and hold Lessor, its agents, employees, lenders and ground lessor, if any, and the Premises, harmless from and against any and all damages, liabilities, judgments, costs, claims, liens, expenses, penalties, loss of permits and attorneys' and consultants' fees arising out of or involving any Hazardous Substance brought onto the Premises by or for Lessee or by anyone under Lessee's control. Lessee's obligations under this Paragraph 6.2(c) shall include, but not be limited to, the effects of any contamination or injury to person, property or the environment created or suffered by Lessee, and the cost of investigation (including consultants' and attorneys' fees and testing), removal, remediation, restoration and/or abatement thereof, or of any contamination therein involved, and shall survive the expiration or earlier termination of this Lease. No termination, cancellation or release agreement entered into by Lessor and Lessee shall release Lessee from its obligations under this Lease with respect to Hazardous Substances, unless specifically so agreed by Lessor in writing at the time of such agreement.

6.3 LESSEE'S COMPLIANCE WITH REQUIREMENTS. Lessee shall, at Lessee's sole cost and expense, fully, diligently and in a timely manner, comply with all "Applicable Requirements," which term is used in this Lease to mean all laws, rules, regulations, ordinances, directives, covenants, easements and restrictions of record, permits, the requirements of any applicable fire insurance underwriter or rating bureau, and the recommendations of Lessor's engineers and/or consultants, relating in any manner to the Premises (including but not limited to matters pertaining to (i) industrial hygiene, (ii) environmental conditions on, in, under or about the Premises, including soil and groundwater conditions, and (iii) the use, generation, manufacture, production, installation, maintenance, removal, transportation, storage, spill, or release of any Hazardous Substance), now in effect or which may hereafter come into effect. Lessee shall, within five (5) days after receipt of Lessor's written request, provide Lessor with copies of all documents and information, including but not limited to permits, registration, manifests, application, reports and certificates, evidencing Lessee's compliance with any Applicable Requirements specified by Lessor, and shall immediately upon receipt, notify Lessor in writing (with copies of any documents involved) of any threatened or actual claim, notice, citation, warning, complaint or report pertaining to or involving failure by Lessee or the Premises to comply with any Applicable Requirements.

6.4 INSPECTION; COMPLIANCE WITH LAW. Lessor, Lessor's agents, employees, contractors and designated representatives, and the holders of any mortgages, deeds of trust or ground leases on the Premises ("Lenders") shall have the right to enter the Premises at any time in the case of an emergency, and otherwise at reasonable times, for the purpose of inspecting the condition of the Premises and for verifying compliance by Lessee with this Lease and all Applicable

Requirements (as defined in Paragraph 6.3), and Lessor shall be entitled to employ experts and/or consultants in connection therewith to advise Lessor with respect to Lessee's activities, including but not limited to Lessee's installation, operation, use, monitoring, maintenance, or removal of any Hazardous Substance on or from the Premises. The costs and expenses of any such inspections shall be paid by the party requesting same, unless a Default or Breach of this Lease by Lessee or a violation of Applicable Requirements or a contamination, caused or materially contributed to by Lessee, is found to exist or to be imminent, or unless the inspection is requested or ordered by a governmental authority as the result of any such existing or imminent violation or contamination. In such case, Lessee shall upon request reimburse Lessor or Lessor's Lender, as the case may be, for the costs and expenses of such inspections.

7. MAINTENANCE, REPAIRS, UTILITY INSTALLATION, TRADE FIXTURES AND ALTERATIONS.

7.1 LESSEE'S OBLIGATIONS.

(a) Subject to the provisions of Paragraphs 7.2 (Lessor's Obligations), 9 (Damage or Destruction), and 14 (Condemnation), Lessee shall, at Lessee's sole cost and expense and at all times, keep the Premises and every part thereof in good order, condition and repair (whether or not such portion of the Premises requiring repair, or the means of repairing the same, are reasonably or readily accessible to Lessee, and whether or not the need for such repairs occurs as a result of Lessee's use, any prior use, the elements or the age of such portion of the Premises), including, without limiting the generality of the foregoing, all equipment or facilities specifically serving the Premises, such as plumbing, heating, air conditioning, ventilating, electrical, lighting facilities, boilers, fired or unfired pressure vessels, fire hose connections if within the Premises, fixtures, interior walls, interior surfaces of exterior walls, ceilings, floors, windows, doors, plate glass, and skylights, but excluding any items which are the responsibility of Lessor pursuant to Paragraph 7.2 below. Lessee, in keeping the Premises in good order, condition and repair, shall exercise and perform good maintenance practices. Lessee's obligations shall include restorations, replacements or renewals when necessary to keep the Premises and all improvements thereon or a part thereof in good order, condition and state or repair.

(c) If Lessee fails to perform Lessee's obligations under this Paragraph 7.1, Lessor may enter upon the Premises after ten (10) days' prior written notice to Lessee (except in the case of an emergency, in which case no notice shall be required), perform such obligations on Lessee's behalf, and put the Premises in good order, condition and repair, in accordance with Paragraph 13.2 below.

7.2 LESSOR'S OBLIGATIONS. Subject to the provisions of Paragraphs 4.2 (Common Area Operating Expenses), 6 (Use), 7.1 (Lessee's Obligations), 9 (Damage or Destruction) and 14 (Condemnation), Lessor, subject to reimbursement pursuant to Paragraph 4.2, shall keep in good order, condition and repair the foundations, exterior walls, structural condition of interior bearing walls, exterior roof, fire sprinkler and/or standpipe and hose (if located in the Common Areas) or other automatic fire extinguishing system including fire alarm and/or smoke

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detection systems and equipment, fire hydrants, parking lots, walkways, parkways, driveways, landscaping, fences, signs and utility systems serving the Common Areas and all parts thereof, as well as providing the services for which there is a Common Area Operating Expense pursuant to Paragraph 4.2. Lessor shall not be obligated to paint the exterior or interior surfaces of exterior walls nor shall Lessor be obligated to maintain, repair or replace windows, doors or plate glass of the Premises. Lessee expressly waives the benefit of any statute now or hereafter in effect which would otherwise afford Lessee the right to make repairs at Lessor's expense or to terminate this Lease because of Lessor's failure to keep the Building, Industrial Center or Common Areas in good order,

condition and repair.

### 7.3 UTILITY INSTALLATIONS, TRADE FIXTURES, ALTERATIONS.

(a) DEFINITIONS; CONSENT REQUIRED. The term "UTILITY INSTALLATIONS" is used in this Lease to refer to all air lines, power panels, electrical distribution, security, fire protection systems, communications systems, lighting fixtures, heating, ventilating and air conditioning equipment, plumbing, and fencing in, on or about the Premises. The term "TRADE FIXTURES" shall mean Lessee's machinery and equipment which can be removed without doing material damage to the Premises. The term "ALTERATIONS" shall mean any modification of the improvements on the Premises which are provided by Lessor under the terms of this Lease, other than Utility Installations or Trade Fixtures. "LESSEE-OWNED ALTERATIONS AND/OR UTILITY INSTALLATIONS" are defined as Alterations and/or Utility Installations made by Lessee that are not yet owned by Lessor pursuant to Paragraph 7.4(a). Lessee shall not make nor cause to be made any Alterations or Utility Installations in, on, under or about the Premises without Lessor's prior written consent. Lessee may, however, make non-structural Utility Installations to the interior of the Premises (excluding the roof) without Lessor's consent but upon notice to Lessor, so long as they are not visible from the outside of the Premises, do not involve puncturing, relocating or removing the roof or any existing walls, or changing or interfering with the fire sprinkler or fire detection systems and the cumulative cost thereof during the term of this Lease as extended does not exceed \$2,500.00.

(b) CONSENT. Any Alterations or Utility Installations that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written form with detailed plans. All consents given by Lessor, whether by virtue of Paragraph 7.3(a) or by subsequent specific consent, shall be deemed conditioned upon: (i) Lessee's acquiring all applicable permits required by governmental authorities; (ii) the furnishing of copies of such permits together with a copy of the plans and specifications for the Alteration or Utility Installation to Lessor prior to commencement of the work thereon; and (iii) the compliance by Lessee with all conditions of said permits in a prompt and expeditious manner. Any Alterations or Utility Installations by Lessee during the term of this Lease shall be done in a good and workmanlike manner, with good and sufficient materials, and be in compliance with all Applicable Requirements. Lessee shall promptly upon completion thereof furnish Lessor with as-built plans and specifications therefor. Lessor may, (but without obligation to do so) condition its consent to any requested Alteration or Utility Installation that costs \$2,500.00 or more upon Lessee's providing Lessor with a lien and completion bond in an amount equal to one and one-half times the estimated cost of such Alteration or Utility Installation.

(c) LIEN PROTECTION. Lessee shall pay when due all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use on the Premises, which claims are or may be secured by any mechanic's or materialmen's lien against the Premises or any interest therein. Lessee shall give Lessor not less than ten (10) days' notice prior to the commencement of any work in, on, or about the Premises, and Lessor shall have the right to post notices of non-responsibility in or on the Premises as provided by law. If Lessee shall, in good faith, contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense, defend and protect itself, Lessor and the Premises against the same and shall pay and satisfy any such adverse judgment that may be rendered thereon before the enforcement thereof against the Lessor or the Premises. If Lessor shall require, Lessee shall furnish to Lessor a surety bond satisfactory to Lessor in an amount equal to one and one-half times the amount of such contested lien claim or demand, indemnifying Lessor against liability for the same, as required by law for the holding of the Premises free from the effect of such lien or claim. In addition, Lessor may require Lessee to pay Lessor's attorneys' fees and costs in participating in such action if Lessor shall decide it is to its best interest to do so.

### 7.4 OWNERSHIP, REMOVAL, SURRENDER, AND RESTORATION.

(a) OWNERSHIP. Subject to Lessor's right to require their removal and to cause Lessee to become the owner thereof as hereinafter provided in this Paragraph 7.4, all Alterations and Utility Installations made to the Premises by Lessee shall be the property of and owned by Lessee, but considered a part of the Premises. Lessor may, at any time and at its option elect in writing to Lessee to be the owner of all or any specified part of the Lessee-Owned

Alterations and Utility Installations. Unless otherwise instructed per Subparagraph 7.4(b) hereof, all Lessee-Owned Alterations and Utility Installations shall, at the expiration or earlier termination of this Lease, become the property of Lessor and remain upon the Premises and be surrendered with the Premises by Lessee.

(b) REMOVAL. Unless otherwise agreed in writing, Lessor may require that any or all Lessee-Owned Alterations or Utility Installations be removed by the expiration or earlier termination of this Lease, notwithstanding that their installation may have been consented to by Lessor. Lessor may require the removal at any time of all or any part of any Alterations or Utility Installations made without the required consent of Lessor.

(c) SURRENDER/RESTORATION. Lessee shall surrender the Premises by the end of the last day of the Lease term or any earlier termination date, clean and free of debris and in good operating order, condition and state of repair, ordinary wear and tear excepted. Ordinary wear and tear shall not include any damage or deterioration that would have been prevented by good maintenance practice or by Lessee performing all of its obligations under this Lease. Except as otherwise agreed or specified herein, the Premises, as surrendered, shall include the Alterations and Utility Installations. The obligation of Lessee shall include the repair of any damage occasioned by the installation, maintenance or removal of Lessee's Trade Fixtures, furnishings, equipment, and Lessee-Owned Alterations and Utility Installations, as well as the removal of any storage tank installed by or for Lessee, and the removal, replacement, or remediation of any soil, material or ground water contaminated by Lessee, all as may then be required by Applicable Requirements and/or good practice. Lessee's Trade Fixtures shall remain the property of Lessee and shall be removed by Lessee subject to its obligation to repair and restore the Premises per this Lease.

## 8. INSURANCE; INDEMNITY.

8.1 PAYMENT OF PREMIUMS. The cost of the premiums for the insurance policies maintained by Lessor under this Paragraph 8 shall be a Common Area Operating Expense pursuant to Paragraph 4.2 hereof. Premiums for policy periods commencing prior to, or extending beyond, the term of this Lease shall be prorated to coincide with the corresponding Commencement Date or Expiration Date.

### 8.2 LIABILITY INSURANCE.

(a) CARRIED BY LESSEE. Lessee shall obtain and keep in force during the term of this Lease a Commercial General Liability policy of insurance protecting Lessee, Lessor and any Lender(s) whose names have been provided to Lessee in writing (as additional insureds) against claims for bodily injury, personal injury and property damage based upon, involving or arising out of the ownership, use, occupancy or maintenance of the Premises and all areas appurtenant thereto. Such insurance shall be on an occurrence basis providing single limit coverage in an amount not less than \$1,000,000 per occurrence with an "Additional Insured-Managers or Lessors of Premises" endorsement and contain the "Amendment of the Pollution Exclusion" endorsement for damage caused by heat, smoke or fumes from a hostile fire. The policy shall not contain any intra-insured exclusions as between insured persons or organizations, but shall include coverage for liability assumed under this Lease as an "INSURED CONTRACT" for the performance of Lessee's indemnity obligations under this Lease. The limits of said insurance required by this Lease or as carried by Lessee shall not, however, limit the liability of Lessee nor relieve Lessee of any obligation hereunder. All insurance to be carried by Lessee shall be primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only.

(b) CARRIED BY LESSOR. Lessor shall also maintain liability insurance described in Paragraph 8.2(a) above, in addition to and not in lieu of, the insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein.

### 8.3 PROPERTY INSURANCE-BUILDING, IMPROVEMENTS AND RENTAL VALUE.

(a) BUILDING AND IMPROVEMENTS. Lessor shall obtain and keep in force during the term of this Lease a policy or policies in the name of Lessor, with loss payable to Lessor and to any Lender(s), insuring against loss or damage to the Premises. Such insurance shall be for full replacement cost, as the same

shall exist from time to time, or the amount required by any Lender(s), but in no event more than the commercially reasonable and available insurable value thereof if, by reason of the unique nature or age of the improvements involved, such latter amount is less than full replacement cost. Lessee-Owned Alterations and Utility Installations, Trade Fixtures and Lessee's personal property shall be insured by Lessee pursuant to Paragraph 8.4. If the coverage is available and commercially appropriate, Lessor's policy or policies shall insure against all risks of direct physical loss or damage (except the perils of flood and/or earthquake, unless required by a Lender), including coverage for any additional costs resulting from debris removal and reasonable amounts of coverage for the enforcement of any ordinance or law regulating the reconstruction or replacement of any undamaged sections of the Building required to be demolished or removed by reason of the enforcement of any building, zoning, safety or land use laws as the result of a covered loss, but not including plate glass insurance. Said policy or policies shall also contain an agreed valuation provision in lieu of any co-insurance clause, waiver of subrogation, and inflation guard protection causing an increase in the annual property insurance coverage amount by a factor of not less than the adjusted U.S. Department of Labor Consumer Price Index for All Urban Consumers for the city nearest to where the Premises are located.

(b) RENTAL VALUE. Lessor may also obtain and keep in force during the term of this Lease a policy or policies in the name of Lessor, with loss payable to Lessor and any Lender(s), insuring the loss of the full rental and other charges payable by all lessees of the Building to Lessor for one year (including all Real Property Taxes, insurance costs, all Common Area Operating Expenses and any scheduled rental increases). Said insurance may provide that in the event the Lease is terminated by reason of an insured loss, the period of indemnity for such coverage shall be extended beyond the date of the completion of repairs or replacement of the Premises, to provide for one full year's loss of rental revenues from the date of any such loss. Said insurance shall contain an agreed valuation provision in lieu of any co-insurance clause, and the amount of coverage shall be adjusted annually to reflect the projected rental income, Real Property Taxes, insurance premium costs and other expenses, if any, otherwise payable, for the next 12-month period. Common Area Operating Expenses shall include any deductible amount in the event of such loss.

(c) ADJACENT PREMISES. Lessee shall pay for any increase in the premiums for the property insurance of the Building and for the Common Areas or other buildings in the Industrial Center if said increase is caused by Lessee's acts, omissions, use or occupancy of the Premises.

(d) LESSEE'S IMPROVEMENTS. Since Lessor is the Insuring Party, Lessor shall not be required to insure Lessee-Owned Alterations and Utility Installations.

8.4 LESSEE'S PROPERTY INSURANCE. Subject to the requirements of Paragraph 8.5, Lessee at its cost shall either by separate policy or, at Lessor's option, by endorsement to a policy already carried, maintain insurance coverage on all of Lessee's personal property, Trade Fixtures and Lessee-Owned Alterations and Utility Installations in, on, or about the Premises similar in coverage to that carried by Lessor as the Insuring Party under Paragraph 8.3(a). Such insurance shall be full replacement cost coverage with a deductible not to exceed \$1,000 per occurrence. The proceeds from any such insurance shall be used by Lessee for the replacement of personal property and the restoration of Trade Fixtures and Lessee-Owned Alterations and Utility Installations. Upon request from Lessor, Lessee shall provide Lessor with written evidence that such insurance is in force.

8.5 INSURANCE POLICIES. Insurance required hereunder\* shall be in companies duly licensed to transact business in the state where the Premises are located, and maintaining during the policy term a "General Policyholders Rating" of at least B+, V, or such other rating as may be required by a Lender, as set forth in the most current issue of "Best's Insurance Guide." Lessee shall not do or permit to be done anything which shall invalidate the insurance policies referred to in

\* may be maintained by Lessee under a blanket policy or policies and

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this Paragraph 8. Lessee shall cause to be delivered to Lessor, within seven (7) days after the earlier of the Early Possession Date or the Commencement Date, certified copies of, or certificates evidencing the existence and amounts of, the insurance required under Paragraph 8.2(a) and 8.4. No such policy shall be cancellable or subject to modification except after thirty (30) days' prior written notice to Lessor. Lessee shall at least thirty (30) days prior to the expiration of such policies, furnish Lessor with evidence of renewals or "insurance binders" evidencing renewal thereof, or Lessor may order such insurance and charge the cost thereof to Lessee, which amount shall be payable by Lessee to Lessor upon demand.

8.6 WAIVER OF SUBROGATION. Without affecting any other rights or remedies, Lessee and Lessor each hereby release and relieve the other, and waive their entire right to recover damages (whether in contract or in tort) against the other, for loss or damage to their property arising out of or incident to the perils required to be insured against under Paragraph 8. The effect of such releases and waivers of the right to recover damages shall not be limited by the amount of insurance carried or required, or by any deductibles applicable thereto. Lessor and Lessee agree to have their respective insurance companies issuing property damage insurance waive any right to subrogation that such companies may have against Lessor or Lessee, as the case may be, so long as the insurance is not invalidated thereby.

8.7 INDEMNITY. Except for Lessor's negligence and/or breach of express warranties, Lessee shall indemnify, protect, defend and hold harmless the Premises, Lessor and its agents, Lessor's master or ground lessor, partners and Lenders, from and against any and all claims, loss of rents and/or damages, costs, liens, judgments, penalties, loss of permits, attorneys' and consultants' fees, expenses and/or liabilities arising out of, involving, or in connection with, the occupancy of the Premises by Lessee, the conduct of Lessee's business, any act, omission or neglect of Lessee, its agents, contractors, employees or invitees, and out of any Default or Breach by Lessee in the performance in a timely manner of any obligation on Lessee's part to be performed under this Lease. The foregoing shall include, but not be limited to, the defense or pursuit of any claim or any action or proceeding involved therein, and whether or not (in the case of claims made against Lessor) litigated and/or reduced to judgment. In case any action or proceeding be brought against Lessor by reason of any of the foregoing matters, Lessee upon notice from Lessor shall defend the same at Lessee's expense by counsel reasonably satisfactory to Lessor and Lessor shall cooperate with Lessee in such defense. Lessor need not have first paid any such claim in order to be so indemnified.

8.8 EXEMPTION OF LESSOR FROM LIABILITY. Lessor shall not be liable for injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessee's employees, contractors, invitees, customers, or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, air conditioning or lighting fixtures, or from any other cause, whether said injury or damage results from conditions arising upon the Premises or upon other portions of the Building of which the Premises are a part, from other sources or places, and regardless of whether the cause of such damage or injury or the means of repairing the same is accessible or not. Lessor shall not be liable for any damages arising from any act or neglect of any other lessee of Lessor nor from the failure by Lessor to enforce the provisions of any other lease in the Industrial Center. Notwithstanding Lessor's negligence or breach of this Lease, Lessor shall under no circumstances be liable for injury to Lessee's business or for any loss of income or profit therefrom.

## 9. DAMAGE OR DESTRUCTION.

### 9.1 DEFINITIONS.

(a) "PREMISES PARTIAL DAMAGE" shall mean damage or destruction to the Premises, other than Lessee-Owned Alterations and Utility Installations, the repair cost of which damage or destruction is less than fifty percent (50%) of the then Replacement Cost (as defined in Paragraph 9.1(d)) of the Premises (excluding Lessee-Owned Alterations and Utility Installations and Trade



Fixtures) immediately prior to such damage or destruction.

(b) "PREMISES TOTAL DESTRUCTION" shall mean damage or destruction to the Premises, other than Lessee-Owned Alterations and Utility Installations, the repair cost of which damage or destruction is fifty percent (50%) or more of the then Replacement Cost of the Premises (excluding Lessee-Owned Alterations and Utility Installations and Trade Fixtures) immediately prior to such damage or destruction. In addition, damage or destruction to the Building, other than Lessee-Owned Alterations and Utility Installations and Trade Fixtures of any lessees of the Building, the cost of which damage or destruction is fifty percent (50%) or more of the then Replacement Cost (excluding Lessee-Owned Alterations and Utility Installations and Trade Fixtures of any lessees of the Building) of the Building shall, at the option of Lessor, be deemed to be Premises Total Destruction.

(c) "INSURED LOSS" shall mean damage or destruction to the Premises, other than Lessee-Owned Alterations and Utility Installations and Trade Fixtures, which was caused by an event required to be covered by the insurance described in Paragraph 8.3(a) irrespective of any deductible amounts or coverage limits involved.

(d) "REPLACEMENT COST" shall mean the cost to repair or rebuild the improvements owned by Lessor at the time of the occurrence to their condition existing immediately prior thereto, including demolition, debris removal and upgrading required by the operation of applicable building codes, ordinances or laws, and without deduction for depreciation.

(e) "HAZARDOUS SUBSTANCE CONDITION" shall mean the occurrence or discovery of a condition involving the presence of, or a contamination by, a Hazardous Substance as defined in Paragraph 6.2(a), in, on, or under the Premises.

9.2 PREMISES PARTIAL DAMAGE -- INSURED LOSS. If Premises Partial Damage that is an Insured Loss occurs, then Lessor shall, at Lessor's expense, repair such damage (but not Lessee's Trade Fixtures or Lessee-Owned Alterations and Utility Installations) as soon as reasonably possible and this Lease shall continue in full force and effect. In the event, however, that there is a shortage of insurance proceeds and such shortage is due to the fact that, by reason of the unique nature of the improvements in the Premises, full replacement cost insurance coverage was not commercially reasonable and available, Lessor shall have no obligation to pay for the shortage in insurance proceeds or to fully restore the unique aspects of the Premises unless Lessee provides Lessor with the funds to cover same, or adequate assurance thereof, within ten (10) days following receipt of written notice of such shortage and request therefor. If Lessor receives said funds or adequate assurance thereof within said ten (10) day period, Lessor shall complete them as soon as reasonably possible and this Lease shall remain in full force and effect. If Lessor does not receive such funds or assurance within said period, Lessor may nevertheless elect by written notice to Lessee within ten (10) days thereafter to make such restoration and repair as is commercially reasonable with Lessor paying any shortage in proceeds, in which case this Lease shall remain in full force and effect. If Lessor does not receive such funds or assurance within such ten (10) day period, and if Lessor does not so elect to restore and repair, then this Lease shall terminate sixty (60) days following the occurrence of the damage or destruction. Unless otherwise agreed, Lessee shall in no event have any right to reimbursement from Lessor for any funds contributed by Lessee to repair any such damage or destruction. Premises Partial Damage due to flood or earthquake shall be subject to Paragraph 9.3 rather than Paragraph 9.2, notwithstanding that there may be some insurance coverage, but the net proceeds of any such insurance shall be made available for the repairs if made by either Party.

9.3 PARTIAL DAMAGE - UNINSURED LOSS. If Premises Partial Damage that is not an Insured Loss occurs, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessee's expense and this Lease shall continue in full force and effect), Lessor may at Lessor's option, either (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) give written notice to Lessee within thirty (30) days after receipt by Lessor of knowledge of the occurrence of such damage of Lessor's desire to terminate this Lease as of the date sixty (60) days following the date of such notice. In the event Lessor elects to give such notice of Lessor's intention to terminate this Lease, Lessee shall have the right within ten (10)

days after the receipt of such notice to give written notice to Lessor of Lessee's commitment to pay for the repair of such damage totally at Lessee's expense and without reimbursement from Lessor. Lessee shall provide Lessor with the required funds or satisfactory assurance thereof within thirty (30) days following such commitment from Lessee. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such repairs as soon as reasonably possible after the required funds are available. If Lessee does not give such notice and provide the funds or assurance thereof within the times specified above, this Lease shall terminate as of the date specified in Lessor's notice of termination.

9.4 TOTAL DESTRUCTION. Notwithstanding any other provision hereof, if Premises Total Destruction occurs (including any destruction required by any authorized public authority), this Lease shall terminate sixty (60) days following the date of such Premises Total Destruction, whether or not the damage or destruction is an insured Loss or was caused by a negligent or willful act of Lessee. In the event, however, that the damage or destruction was caused by Lessee, Lessor shall have the right to recover Lessor's damages from Lessee except as released and waived in Paragraph 9.7.

9.5 DAMAGE NEAR END OF TERM. If at any time during the last six (6) months of the term of this Lease there is damage for which the cost to repair exceeds one month's Base Rent, whether or not an Insured Loss, Lessor may, at Lessor's option, terminate this Lease effective sixty (60) days following the date of occurrence of such damage by giving written notice to Lessee of Lessor's election to do so within thirty (30) days after the date of occurrence of such damage. Provided, however, if Lessee at that time has an exercisable option to extend this Lease or to purchase the Premises, then Lessee may preserve this Lease by (a) exercising such option, and (b) providing Lessor with any shortage in insurance proceeds (or adequate assurance thereof) needed to make the repairs on or before the earlier of (i) the date which is ten (10) days after Lessee's receipt of Lessor's written notice purporting to terminate this Lease, or (ii) the day prior to the date upon which such option expires. If Lessee duly exercises such option during such period and provides Lessor with funds (or adequate assurance thereof) to cover any shortage in insurance proceeds, Lessor shall, at Lessor's expense repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect. If Lessee fails to exercise such option and provide such funds or assurance during such period, then this Lease shall terminate as of the date set forth in the first sentence of this Paragraph 9.5.

#### 9.6 ABATEMENT OF RENT; LESSEE'S REMEDIES.

(a) In the event of (i) Premises Partial Damage or (ii) Hazardous Substance Condition for which Lessee is not legally responsible, the Base Rent, Common Area Operating Expenses and other charges, if any, payable by Lessee hereunder for the period during which such damage or condition, its repair, remediation or restoration continues, shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired, but not in excess of proceeds from insurance required to be carried under Paragraph 8.3(b). Except for abatement of Base Rent, Common Area Operating Expenses and other charges, if any, as aforesaid, all other obligations of Lessee hereunder shall be performed by Lessee, and Lessee shall have no claim against Lessor for any damage suffered by reason of any such damage, destruction, repair, remediation or restoration.

(b) If Lessor shall be obligated to repair or restore the Premises under the provisions of this Paragraph 9 and shall not commence, in a substantial and meaningful way, the repair or restoration of the Premises within ninety (90) days after such obligation shall accrue, Lessee may, at any time prior to the commencement of such repair or restoration, give written notice to Lessor and to any Lenders of which Lessee has actual notice of Lessee's election to terminate this Lease on a date not less than sixty (60) days following the giving of such notice. If Lessee gives such notice to Lessor and such Lenders and such repair or restoration is not commenced within thirty (30) days after receipt of such notice, this Lease shall terminate as of the date specified in said notice. If Lessor or a Lender commences the repair or restoration of the Premises within thirty (30) days after the receipt of such notice, this Lease shall continue in full force and effect. "COMMENCE" as used in this Paragraph 9.6 shall mean either the unconditional authorization of the preparation of the required plans, or the beginning of the actual work on the Premises, whichever occurs first.

9.7 HAZARDOUS SUBSTANCE CONDITIONS. If a Hazardous Substance Condition occurs, unless Lessee is legally responsible therefor (in which case Lessee shall make the investigation and remediation thereof required by Applicable Requirements and this Lease shall continue in full force and effect, but subject

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to Lessor's rights under Paragraph 6.2(c) and Paragraph 13), Lessor may at Lessor's option either (i) investigate and remediate such Hazardous Substance Condition, if required, as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) if the estimated cost to investigate and remediate such condition exceeds twelve (12) times the then monthly Base Rent or \$100,000 whichever is greater, give written notice to Lessee within thirty (30) days after receipt by Lessor of knowledge of the occurrence of such Hazardous Substance Condition of Lessor's desire to terminate this Lease as of the date sixty (60) days following the date of such notice. In the event Lessor elects to give such notice of Lessor's intention to terminate this Lease, Lessee shall have the right within ten (10) days after the receipt of such notice to give written notice to Lessor of Lessee's commitment to pay for the excess costs of (a) investigation and remediation of such Hazardous Substance Condition to the extent required by Applicable Requirements, over (b) an amount equal to twelve (12) times the then monthly Base Rent or \$100,000, whichever is greater. Lessee shall provide Lessor with the funds required of Lessee or satisfactory assurance thereof within thirty (30) days following said commitment by Lessee. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such investigation and remediation as soon as reasonably possible after the required funds are available. If Lessee does not give such notice and provide the required funds or assurance thereof within the time period specified above, this Lease shall terminate as of the date specified in Lessor's notice of termination.

9.8 TERMINATION -- ADVANCE PAYMENTS. Upon termination of this Lease pursuant to this Paragraph 9, Lessor shall return to Lessee any advance payment made by Lessee to Lessor and so much of Lessee's Security Deposit as has not been, or is not then required to be, used by Lessor under the terms of this Lease.

9.9 WAIVER OF STATUTES. Lessor and Lessee agree that the terms of this Lease shall govern the effect of any damage to or destruction of the Premises and the Building with respect to the termination of this Lease and hereby waive the provisions of any present or future statute to the extent it is inconsistent herewith.

#### 10. REAL PROPERTY TAXES.

10.1 PAYMENT OF TAXES. Lessor shall pay the Real Property Taxes, as defined in Paragraph 10.2, applicable to the Industrial Center, and except as otherwise provided in Paragraph 10.3, any such amounts shall be included in the calculation of Common Area Operating Expenses in accordance with the provisions of Paragraph 4.2.

10.2 REAL PROPERTY TAX DEFINITION. As used herein, the term "REAL PROPERTY TAXES" shall include any form of real estate tax or assessment, general, special, ordinary or extraordinary, and any license fee, commercial rental tax, improvement bond or bonds, levy or tax (other than inheritance, personal income or estate taxes) imposed upon the Industrial Center by any authority having the direct or indirect power to tax, including any city, state or federal government, or any school, agricultural, sanitary, fire, street, drainage, or other improvement district thereof, levied against any legal or equitable interest of Lessor in the Industrial Center or any portion thereof, Lessor's right to rent or other income therefrom, and/or Lessor's business of leasing the Premises. The term "REAL PROPERTY TAXES" shall also include any tax, fee, levy, assessment or charge, or any increase therein, imposed by reason of events occurring, or changes in Applicable Law taking effect, during the term of

this Lease, including but not limited to a change in the ownership of the Industrial Center or in the improvements thereon, the execution of this Lease, or any modification, amendment or transfer thereof, and whether or not contemplated by the Parties. In calculating Real Property Taxes for any calendar year, the Real Property Taxes for any real estate tax year shall be included in the calculation of Real Property Taxes for such calendar year based upon the number of days which such calendar year and tax year have in common.

10.3 ADDITIONAL IMPROVEMENTS. Common Area Operating Expenses shall not include Real Property Taxes specified in the tax assessor's records and work sheets as being caused by additional improvements placed upon the Industrial Center by other lessees or by Lessor for the exclusive enjoyment of such other lessees. Notwithstanding Paragraph 10.1 hereof, Lessee shall, however, pay to Lessor at the time Common Area Operating Expenses are payable under Paragraph 4.2, the entirety of any increase in Real Property Taxes if assessed solely by reason of Alterations, Trade Fixtures or Utility Installations placed upon the Premises by Lessee or at Lessee's request.

10.4 JOINT ASSESSMENT. If the Building is not separately assessed, Real Property Taxes allocated to the Building shall be an equitable proportion of the Real Property Taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available. Lessor's reasonable determination thereof, in good faith, shall be conclusive.

10.5 LESSEE'S PROPERTY TAXES. Lessee shall pay prior to delinquency all taxes assessed against and levied upon Lessee-Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all personal property of Lessee contained in the Premises or stored within the Industrial Center. When possible, Lessee shall cause its Lessee-Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor. If any of Lessee's said property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee's property within ten (10) days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. UTILITIES. Lessee shall pay directly for all utilities and services supplied to the Premises, including but not limited to electricity, telephone, security, gas and cleaning of the Premises, together with any taxes thereon. If any such utilities or services are not separately metered to the Premises or separately billed to the Premises, Lessee shall pay to Lessor a reasonable proportion to be determined by Lessor of all such charges jointly metered or billed with other premises in the Building, in the manner and within the time periods set forth in Paragraph 4.2(d).

12. ASSIGNMENT AND SUBLETTING.

12.1 LESSOR'S CONSENT REQUIRED.

(a) Lessee shall not voluntarily or by operation of law assign, transfer, mortgage or otherwise transfer or encumber (collectively, "assign") or sublet all or any part of Lessee's interest in this Lease or in the Premises without Lessor's prior written consent given under and subject to the terms of Paragraph 36.

(b) A change in the control of Lessee shall constitute an assignment requiring Lessor's consent. The transfer, on a cumulative basis, of twenty-five percent (25%) or more of the voting control of Lessee shall constitute a change in control for this purpose.

(c) The involvement of Lessee or its assets in any transaction, or series of transactions (by way of merger, sale, acquisition, financing, refinancing, transfer, leveraged buy-out or otherwise), whether or not a formal assignment or hypothecation of this Lease or Lessee's assets occurs, which results or will result in a reduction of the Net Worth of Lessee, as hereinafter defined, by an amount equal to or greater than twenty-five percent (25%) of such Net Worth of Lessee as it was represented to Lessor at the time of full execution and delivery of this Lease or at the time of the most recent assignment to which Lessor has consented, or as it exists immediately prior to said transaction or transactions constituting such reduction, at whichever time said Net Worth of Lessee was or is greater, shall be considered an assignment of

this Lease by Lessee to which Lessor may reasonably withhold its consent. "NET WORTH OF LESSEE" for purposes of this Lease shall be the net worth of Lessee (excluding any Guarantors) established under generally accepted accounting principles consistently applied.

(d) An assignment or subletting of Lessee's interest in this Lease without Lessor's specific prior written consent shall, at Lessor's option, be a Default curable after notice per Paragraph 13.1, or a non-curable Breach without the necessity of any notice and grace period. If Lessor elects to treat such unconsented to assignment or subletting as a non-curable Breach, Lessor shall have the right to either: (i) terminate this Lease, or (ii) upon thirty (30) days' written notice ("LESSOR'S NOTICE"), increase the monthly Base Rent for the Premises to the greater of the then fair market rental value of the Premises, as reasonably determined by Lessor, or one hundred ten percent (110%) of the Base Rent then in effect. Pending determination of the new fair market rental value if disputed by Lessee. Lessee shall pay the amount set forth in Lessor's Notice, with any overpayment credited against the next installment(s) of Base Rent coming due, and any underpayment for the period retroactively to the effective date of the adjustment being due and payable immediately upon the determination thereof. Further, in the event of such Breach and rental adjustment, (i) the purchase price of any option to purchase the Premises held by Lessee shall be subject to similar adjustment to the then fair market value as reasonably determined by Lessor (without the Lease being considered an encumbrance or any deduction for depreciation or obsolescence, and considering the Premises at its highest and best use and in good condition) or one hundred ten percent (110%) of the price previously in effect, (ii) any index-oriented rental or price adjustment formulas contained in this Lease shall be adjusted to require that the base index be determined with reference to the index applicable to the time of such adjustment, and (iii) any fixed rental adjustments scheduled during the remainder of the Lease term shall be increased in the same ratio as the new rental bears to the Base Rent in effect immediately prior to the adjustment specified in Lessor's Notice.

(e) Lessee's remedy for any breach of this Paragraph 12.1 by Lessor shall be limited to compensatory damages and/or injunctive relief.

## 12.2 TERMS AND CONDITIONS APPLICABLE TO ASSIGNMENT AND SUBLETTING.

(a) Regardless of Lessor's consent, any assignment or subletting shall not (i) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (ii) release Lessee of any obligations hereunder, nor (iii) alter the primary liability of Lessee for the payment of Base Rent and other sums due Lessor hereunder or for the performance of any other obligations to be performed by Lessee under this Lease.

(b) Lessor may accept any rent or performance of Lessee's obligations from any person other than Lessee pending approval or disapproval of an assignment. Neither a delay in the approval or disapproval of such assignment nor the acceptance of any rent for performance shall constitute a waiver or estoppel of Lessor's right to exercise its remedies for the Default or Breach by Lessee of any of the terms, covenants or conditions of this Lease.

(c) The consent of Lessor to any assignment or subletting shall not constitute a consent to any subsequent assignment or subletting by Lessee or to any subsequent or successive assignment or subletting by the assignee or sublessee. However, Lessor may consent to subsequent sublettings and assignments of the sublease or any amendments or modifications thereto without notifying Lessee or anyone else liable under this Lease or the sublease and without obtaining their consent, and such action shall not relieve such persons from liability under this Lease or the sublease.

(d) In the event of any Default or Breach of Lessee's obligation under this Lease, Lessor may proceed directly against Lessee, any Guarantors or anyone else responsible for the performance of the Lessee's obligations under this Lease, including any sublessee, without first exhausting Lessor's remedies against any other person or entity responsible therefor to Lessor, or any security held by Lessor.

(e) Each request for consent to an assignment or subletting shall be in writing, accompanied by information relevant to Lessor's determination as to the financial and operational responsibility and appropriateness of the proposed assignee or sublessee, including but not limited to the intended use and/or required modification of the Premises, if any, together with a non-refundable

deposit of \$1,000 or ten percent (10%) of the monthly Base Rent applicable to the portion of the Premises which is the subject of the proposed assignment or sublease, whichever is greater, as reasonable consideration for Lessor's considering and processing the request for consent. Lessee agrees to provide Lessor with such other or additional information and/or documentation as may be reasonably requested by Lessor.

(f) Any assignee of, or sublessee under, this Lease shall, by reason of accepting such assignment or entering into such sublease, be deemed, for the benefit of Lessor, to have assumed and agreed to conform and comply with each and every term, covenant, condition and obligation herein to be observed or performed by Lessee during the term of said assignment or sublease, other than such obligations as are contrary to or inconsistent with provisions of an assignment or sublease to which Lessor has specifically consented in writing.

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(g) The occurrence of a transaction described in Paragraph 12.2(c) shall give Lessor the right (but not the obligation) to require that the Security Deposit be increased by an amount equal to six (6) times the then monthly Base Rent, and Lessor may make the actual receipt by Lessor of the Security Deposit increase a condition to Lessor's consent to such transaction.

(h) Lessor, as a condition to giving its consent to any assignment or subletting, may require that the amount and adjustment schedule of the rent payable under this Lease be adjusted to what is then the market value and/or adjustment schedule for property similar to the Premises as then constituted, as determined by Lessor.

12.3 ADDITIONAL TERMS AND CONDITIONS APPLICABLE TO SUBLETTING. The following terms and conditions shall apply to any subletting by Lessee of all or any part of the Premises and shall be deemed included in all subleases under this Lease whether or not expressly incorporated therein:

(a) Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all rentals and income arising from any sublease of all or a portion of the Premises heretofore or hereafter made by Lessee, and Lessor may collect such rent and income and apply same toward Lessee's obligations under this Lease; provided, however, that until a Breach (as defined in Paragraph 13.1) shall occur in the performance of Lessee's obligations under this Lease, Lessee may, except as otherwise provided in this Lease, receive, collect and enjoy the rents accruing under such sublease. Lessor shall not, by reason of the foregoing provision or any other assignment of such sublease to Lessor, nor by reason of the collection of the rents from a sublessee, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee under such Sublease. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice from Lessor stating that a Breach exists in the performance of Lessee's obligations under this Lease, to pay to Lessor the rents and other charges due and to become due under the sublease. Sublessee shall rely upon any such statement and request from Lessor and shall pay such rents and other charges to Lessor without any obligation or right to inquire as to whether such Breach exists and notwithstanding any notice from or claim from Lessee to the contrary. Lessee shall have no right or claim against such sublessee, or, until the Breach has been cured, against Lessor, for any such rents and other charges so paid by said sublessee to Lessor.

(b) In the event of a Breach by Lessee in the performance of its obligations under this Lease, Lessor, at its option and without any obligation to do so, may require any sublessee to attorn to Lessor, in which event Lessor shall undertake the obligations of the sublessor under such sublease from the time of the exercise of said option to the expiration of such sublease; provided, however, Lessor shall not be liable for any prepaid rents or security deposit paid by such sublessee to such sublessor or for any other prior defaults or breaches of such sublessor under such sublease.

(c) Any matter or thing requiring the consent of the sublessor under a sublease shall also require the consent of Lessor herein.

(d) No sublessee under a sublease approved by Lessor shall further assign or sublet all or any part of the Premises without Lessor's prior written consent.

(e) Lessor shall deliver a copy of any notice of Default or Breach by Lessee to the sublessee, who shall have the right to cure the Default of Lessee within the grace period, if any, specified in such notice. The sublessee shall have a right of reimbursement and offset from and against Lessee for any such Defaults cured by the sublessee. See Paragraph 55

### 13. DEFAULT; BREACH; REMEDIES.

13.1 DEFAULT; BREACH. Lessor and Lessee agree that if an attorney is consulted by Lessor in connection with a Lessee Default or Breach (as hereinafter defined), \$350.00 is a reasonable minimum sum per such occurrence for legal services and costs in the preparation and service of a notice of Default, and that Lessor may include the cost of such services and costs in said notice as rent due and payable to cure said default. A "DEFAULT" by Lessee is defined as a failure by Lessee to observe, comply with or perform any of the terms, covenants, conditions or rules applicable to Lessee under this Lease. A "BREACH" by Lessee is defined as the occurrence of any one or more of the following Defaults, and, where a grace period for cure after notice is specified herein, the failure by Lessee to cure such Default prior to the expiration of the applicable grace period, and shall entitle Lessor to pursue the remedies set forth in Paragraphs 13.2 and/or 13.3:

(a) The vacating of the Premises without the intention to reoccupy same, or the abandonment of the Premises.

(b) Except as expressly otherwise provided in this Lease, the failure by Lessee to make any payment of Base Rent, Lessee's Share of Common Area Operating Expenses, or any other monetary payment required to be made by Lessee hereunder as and when due, the failure by Lessee to provide Lessor with reasonable evidence of insurance or surety bond required under this Lease, or the failure of Lessee to fulfill any obligation under this Lease which endangers or threatens life or property, where such failure continues for a period of three (3) days following written notice thereof by or on behalf of Lessor to Lessee.

(c) Except as expressly otherwise provided in this Lease, the failure by Lessee to provide Lessor with reasonable written evidence) in duly executed original form, if applicable) of (i) compliance with Applicable Requirements per Paragraph 6.3, (ii) the inspection, maintenance and service contracts required under Paragraph 7.1(b), (iii) the rescission of an unauthorized assignment or subletting per Paragraph 12.1, (iv) a Tenancy Statement per Paragraphs 16 or 37, (v) the subordination or non-subordination of this Lease per Paragraph 30, (vi) the guaranty of the performance of Lessee's obligations under this Lease if required under Paragraphs 1.11 and 37, (vii) the execution of any document requested under Paragraph 42 (easements), or (viii) any other documentation or information which Lessor may reasonably require of Lessee under the terms of this lease, where any such failure continues for a period of ten (10) days following written notice by or on behalf of Lessor to Lessee.

(d) A Default by Lessee as to the terms, covenants, conditions or provisions of this Lease, or of the rules adopted under Paragraph 40 hereof that are to be observed, complied with or performed by Lessee, other than those described in Subparagraphs 13.1(a), (b) or (c), above, where such Default continues for a period of thirty (30) days after written notice thereof by or on behalf of Lessor to Lessee; provided, however, that if the nature of Lessee's Default is such that more than thirty (30) days are reasonably required for its cure, then it shall not be deemed to be a Breach of this Lease by Lessee if Lessee commences such cure within said thirty (30) day period and thereafter diligently prosecutes such cure to completion.

(e) The occurrence of any of the following events: (i) the making by Lessee of any general arrangement or assignment for the benefit of creditors; (ii) Lessee's becoming a "debtor" as defined in 11 U.S. Code Section 101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within sixty (60) days); (iii) the

appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where possession is not restored to Lessee within thirty (30) days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged within thirty (30) days; provided, however, in the event that any provision of this Subparagraph 13.1(e) is contrary to any applicable law, such provision shall be of no force or effect, and shall not affect the validity of the remaining provisions.

(f) The discovery by Lessor that any financial statement of Lessee or of any Guarantor, given to Lessor by Lessee or any Guarantor, was materially false.

13.2 REMEDIES. If Lessee fails to perform any affirmative duty or obligation of Lessee under this Lease, within ten (10) days after written notice to Lessee (or in case of an emergency, without notice), Lessor may at its option (but without obligation to do so), perform such duty or obligation on Lessee's behalf, including but not limited to the obtaining or reasonably required bonds, insurance policies, or governmental licenses, permits or approvals. The costs and expenses of any such performance by Lessor shall be due and payable by Lessee to Lessor upon invoice therefor. If any check given to Lessor by Lessee shall not be honored by the bank upon which it is drawn, Lessor, at its own option, may require all future payments to be made under this Lease by Lessee to be made only by cashier's check. In the event of a Breach of this Lease by Lessee (as defined in Paragraph 13.1), with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such Breach, Lessor may:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease and the term hereof shall terminate and Lessee shall immediately surrender possession of the Premises to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the worth at the time of the award of the unpaid rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided; and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by the Lessee's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, including but not limited to the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorney's fees, and that portion of any leasing commission paid by Lessor in connection with this Lease applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provision (iii) of the immediately preceding sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco or the Federal Reserve Bank District in which the Premises are located at the time of award plus one percent (1%). Efforts by Lessor to mitigate damages caused by Lessee's Default or Breach of this Lease shall not waive Lessor's right to recover damages under this Paragraph 13.2. If termination of this Lease is obtained through the provisional remedy of unlawful detainer. Lessor shall have the right to recover in such proceeding the unpaid rent and damages as are recoverable therein, or Lessor may reserve the right to recover all or any part thereof in a separate suit for such rent and/or damages. If a notice and grace period required under Subparagraph 13.1(b), (c) and (d) was not previously given, a notice to pay rent or quit, or to perform or quit, as the case may be, given to Lessee under any statute authorizing the forfeiture of leases for unlawful detainer shall also constitute the applicable notice for grace period purposes required by Subparagraph 13.1(b), (c) and (d). In such case, the applicable grace period under the unlawful detainer statute shall run concurrently after the one such statutory notice, and the failure of Lessee to cure the Default within the greater of the two (2) such grace periods shall constitute both an unlawful detainer and a Breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession in effect (in California Civil Code Section 1951.4) after Lessee's Breach and recover the rent as it becomes due, provided Lessee has the right to sublet or assign,



subject only to reasonable limitations. Lessor and Lessee agree that the limitations on assignment and subletting in this Lease are reasonable. Acts of maintenance or preservation, efforts to relet the Premises, or the appointment of a receiver to protect the Lessor's interest under this Lease, shall not constitute a termination of the Lessee's right to possession.

(c) Pursue any other remedy now or hereafter available to Lessor under the laws or judicial decisions of the state wherein the Premises are located.

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(d) The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

13.4 LATE CHARGES. Lessee hereby acknowledges that late payment by Lessee to Lessor of rent and other sums due hereunder will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed upon Lessor by the terms of any ground lease, mortgage or deed of trust covering the Premises. Accordingly, if any installment of rent or other sum due from Lessee shall not be received by Lessor or Lessor's designee within ten (10) days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall pay to Lessor a late charge equal to six percent (6%) of such overdue amount. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of late payment by Lessee. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's Default or Breach with respect to such overdue amount, nor prevent Lessor from exercising any of the other rights and remedies granted hereunder. In the event that a late charge is payable hereunder, whether or not collected, for three (3) consecutive installments of Base Rent, then notwithstanding Paragraph 4.1 or any other provision of this Lease to the contrary, Base Rent shall, at Lessor's option, become due and payable quarterly in advance.

13.5 BREACH BY LESSOR. Lessor shall not be deemed in breach of this Lease unless Lessor fails within a reasonable time to perform an obligation required to be performed by Lessor. For purposes of this Paragraph 13.5, a reasonable time shall in no event be less than thirty (30) days after receipt by Lessor, and by any Lender(s) whose name and address shall have been furnished to Lessee in writing for such purpose, of written notice specifying wherein such obligation of Lessor has not been performed; provided, however, that if the nature of Lessor's obligation is such that more than thirty (30) days after such notice are reasonably required for its performance, then Lessor shall not be in breach of this Lease if performance is commenced within such thirty (30) day period and thereafter diligently pursued to completion.

14. CONDEMNATION. If the Premises or any portion thereof are taken under the power of eminent domain or sold under the threat of the exercise of said power (all of which are herein called "condemnation"), this Lease shall terminate as to the part so taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than ten percent (10%) of the floor area of the Premises, or more than twenty-five percent (25%) of the portion of the Common Areas designated for Lessee's parking, is taken by condemnation, Lessee may, at Lessee's option, to be exercised in writing within ten (10) days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within ten (10) days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the Base Rent shall be reduced in the same proportion as the rentable floor area of the Premises taken bears to the total rentable floor area of the Premises. No reduction of Base

Rent shall occur if the condemnation does not apply to any portion of the Premises. Any award for the taking of all or any part of the Premises under the power of eminent domain or any payment made under threat of the exercise of such power shall be the property of Lessor, whether such award shall be made as compensation for diminution of value of the leasehold or for the taking of the fee, or as severance damages; provided, however, that Lessee shall be entitled to any compensation, separately awarded to Lessee for Lessee's relocation expenses and/or loss of Lessee's Trade Fixtures. In the event that this Lease is not terminated by reason of such condemnation, Lessor shall to the extent of its net severance damages received, over and above Lessee's Share of the legal and other expenses incurred by Lessor in the condemnation matter, repair any damage to the Premises caused by such condemnation authority. Lessee shall be responsible for the payment of any amount in excess of such net severance damages required to complete such repair.

## 16. TENANCY AND FINANCIAL STATEMENTS.

16.1 TENANCY STATEMENT. Each Party (as "RESPONDING PARTY") shall within ten (10) days after written notice from the other Party (the "REQUESTING PARTY") execute, acknowledge and deliver to the Requesting Party a statement in writing in a form similar to the then most current "TENANCY STATEMENT" form published by the American Industrial Real Estate Association, plus such additional information, confirmation and/or statements as may be reasonably requested by the Requesting Party.

16.2 FINANCIAL STATEMENT. If Lessor desires to finance, refinance, or sell the Premises or the Building, or any part thereof, Lessee and all Guarantors shall deliver to any potential lender or purchaser designated by Lessor such financial statements of Lessee and such Guarantors as may be reasonably required by such lender or purchaser, including but not limited to Lessee's financial statements for the past three (3) years. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. LESSOR'S LIABILITY. The term "LESSOR" as used herein shall mean the owner or owners at the time in question of the fee title to the Premises. In the event of a transfer of Lessor's title or interest in the Premises or in this Lease, Lessor shall deliver to the transferee or assignee (in cash or by credit) any unused Security Deposit held by Lessor at the time of such transfer or assignment. Except as provided in Paragraph 15.3, upon such transfer or assignment and delivery of the Security Deposit, as aforesaid, the prior Lessor shall be relieved of all liability with respect to the obligations and/or covenants under this Lease thereafter to be performed by the Lessor. Subject to the foregoing, the obligations and/or covenants in this Lease to be performed by the Lessor shall be binding only upon the Lessor as hereinabove defined.

18. SEVERABILITY. The invalidity of any provision of this Lease, as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

19. INTEREST ON PAST-DUE OBLIGATIONS. Any monetary payment due Lessor hereunder, other than late charges, not received by Lessor within ten (10) days following the date on which it was due, shall bear interest from the date due at the prime rate of 10% per annum, in addition to the potential late charge provided for in Paragraph 13.4.

20. TIME OF ESSENCE. Time is of the essence with respect to the performance of all obligations to be performed or observed by the Parties under this Lease.

21. RENT DEFINED. All monetary obligations of Lessee to Lessor under the terms of this Lease are deemed to be rent.

22. NO PRIOR OR OTHER AGREEMENTS. This Lease contains all agreements between the parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective. Lessor and Lessee each represents and warrants to the Brokers that it has made, and is relying solely upon, its own investigation as to the nature, quality, character and financial responsibility of the other Party to this Lease and as to the nature, quality and character of the Premises. See Paragraph 56.

23. NOTICES.

23.1 NOTICE REQUIREMENTS. All notices required or permitted by this Lease shall be in writing and may be delivered in person (by hand or by messenger or courier service) or may be sent by regular, certified or registered mail or U.S. Postal Service Express Mail, with postage prepaid, or by facsimile transmission during normal business hours, and shall be deemed sufficiently given if served in a manner specified in this Paragraph 23. The addresses noted adjacent to a Party's signature on this Lease shall be that Party's address for delivery or mailing of notice purposes. Either Party may by written notice to the other specify a different address for notice purposes, except that upon Lessee's taking possession of the Premises, the Premises shall constitute Lessee's address for the purpose of mailing or delivering notices to Lessee. A copy of all notices required or permitted to be given to Lessor hereunder shall be concurrently transmitted to such party or parties at such addresses as Lessor may from time to time hereafter designate by written notice to Lessee.

23.2 DATE OF NOTICE. Any notice sent by registered or certified mail, return receipt requested, shall be deemed given on the date of delivery shown on the receipt card, or if no delivery date is shown, the postmark thereon. If sent by regular mail, the notice shall be deemed given forty-eight (48) hours after the same is addressed as required herein and mailed with postage prepaid. Notices delivered by United States Express Mail or overnight courier that guarantees next day

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delivery shall be deemed given twenty-four (24) hours after delivery of the same to the United States Postal Service or courier. If any notice is transmitted by facsimile transmission or similar means, the same shall be deemed served or delivered upon telephone or facsimile confirmation of receipt of the transmission thereof provided a copy is also delivered via delivery or mail. If notice is received on a Saturday or a Sunday or a legal holiday, it shall be deemed received on the next business day.

24. WAIVERS. No waiver by Lessor of the Default or Breach of any term, covenant or condition hereof by Lessee, shall be deemed a waiver of any other term, covenant or condition hereof, or of any subsequent Default or Breach by Lessee of the same or any other term, covenant or condition hereof. Lessor's consent to, or approval of, any such act shall not be deemed to render unnecessary the obtaining of Lessor's consent to, or approval of, any subsequent or similar act by Lessee, or be construed as the basis of an estoppel to enforce the provision or provisions of this Lease requiring such consent. Regardless of Lessor's knowledge of a Default or Breach at the time of accepting rent, the acceptance of rent by Lessor shall not be a waiver of any Default or Breach by Lessee of any provision hereof. Any payment given Lessor by Lessee may be accepted by Lessor on account of moneys or damages due Lessor, notwithstanding any qualifying statements or conditions made by Lessee in connection therewith, which such statements and/or conditions shall be of no force or effect whatsoever, unless specifically agreed to in writing by Lessor at or before the time of deposit of such payment.

25. RECORDING. Either Lessor or Lessee shall, upon request of the other, execute, acknowledge and deliver to the other a short form memorandum of this Lease for recording purposes. The Party requesting recordation shall be responsible for payment of any fees or taxes applicable thereto.

26. NO RIGHT TO HOLDOVER. Lessee has no right to retain possession of the Premises or any part thereof beyond the expiration or earlier termination of this Lease. In the event that Lessee holds over in violation of this Paragraph 26 then the Base Rent payable from and after the time of the expiration or earlier termination of this Lease shall be increased to two hundred percent (200%) of the Base Rent applicable during the month immediately preceding such expiration or earlier termination. Nothing contained herein shall be construed as a consent by Lessor to any holding over by Lessee.

27. CUMULATIVE REMEDIES. No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at

law or in equity.

28. COVENANTS AND CONDITIONS. All provisions of this Lease to be observed or performed by Lessee are both covenants and conditions.

29. BINDING EFFECT; CHOICE OF LAW. This Lease shall be binding upon the Parties, their personal representatives, successors and assigns and be governed by the laws of the State in which the Premises are located. Any litigation between the Parties hereto concerning this Lease shall be initiated in the county in which the Premises are located.

30. SUBORDINATION; ATTORNMENT; NON-DISTURBANCE.

30.1 SUBORDINATION. This Lease and any Option granted hereby shall be subject and subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively "SECURITY DEVICE"), now or hereafter placed by Lessor upon the real property of which the Premises are a part, to any and all advances made on the security thereof, and to all renewals, modifications, consolidations, replacements and extensions thereof. Lessee agrees that the Lenders holding any such Security Device shall have no duty, liability or obligation to perform any of the obligations of Lessor under this Lease, but that in the event of Lessor's default with respect to any such obligation, Lessee will give any Lender whose name and address have been furnished Lessee in writing for such purpose notice of Lessor's default pursuant to Paragraph 13.5. If any Lender shall elect to have this Lease and/or any Option granted hereby superior to the lien of its Security Device and shall give written notice thereof to Lessee, this Lease and such Options shall be deemed prior to such Security Device, notwithstanding the relative dates of the documentation or recordation thereof.

30.2 ATTORNMENT. Subject to the non-disturbance provisions of Paragraph 30.3, Lessee agrees to attorn to a Lender or any other party who acquires ownership of the Premises by reason of a foreclosure of a Security Device, and that in the event of such foreclosure, such new owner shall not: (i) be liable for any act or omission of any prior lessor or with respect to events occurring prior to acquisition of ownership, (ii) be subject to any offsets or defenses which Lessee might have against any prior lessor, or (iii) be bound by prepayment of more than one month's rent.

30.3 NON-DISTURBANCE. With respect to Security Devices entered into by Lessor after the execution of this lease, Lessee's subordination of this Lease shall be subject to receiving assurance (a "non-disturbance agreement") from the Lender that Lessee's possession and this Lease, including any options to extend the term hereof, will not be disturbed so long as Lessee is not in Breach hereof and attorns to the record owner of the Premises.

30.4 SELF-EXECUTING. The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents; provided, however, that upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of Premises, Lessee and Lessor shall execute such further writings as may be reasonably required to separately document any such subordination or non-subordination, attornment and/or non-disturbance agreement as is provided for herein.

31. ATTORNEY'S FEES. If any Party or Broker brings an action or proceeding to enforce the terms hereof or declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorney's fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term "PREVAILING PARTY" shall include, without limitation, a Party or Broker who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party or Broker of its claim or defense. The attorneys' fee award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. Lessor shall be entitled to attorneys' fees, costs and expenses incurred in preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach. Broker(s) shall be intended third party beneficiaries of this Paragraph 31.

32. LESSOR'S ACCESS; SHOWING PREMISES; REPAIRS. Lessor and Lessor's agents shall have the right to enter the Premises at any time, in the case of an

emergency, and otherwise at reasonable times for the purpose of showing the same to prospective purchasers, lenders, or lessees, and making such alterations, repairs, improvements or additions to the Premises or to the Building, as Lessor may reasonably deem necessary. Lessor may at any time place on or about the Premises or Building any ordinary "For Sale" signs and Lessor may at any time during the last one hundred eighty (180) days of the term hereof place on or about the Premises any ordinary "For Lease" signs. All such activities of Lessor shall be without abatement of rent or liability to Lessee.

33. AUCTIONS. Lessee shall not conduct, nor permit to be conducted, either voluntarily or involuntarily, any auction upon the Premises without first having obtained Lessor's prior written consent. Notwithstanding anything to the contrary in this Lease, Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to grant such consent.

34. SIGNS. Lessee shall not place any sign upon the exterior of the Premises or the Building, except that Lessee may, with Lessor's prior written consent, install (but not on the roof) such signs as are reasonably required to advertise Lessee's own business so long as such signs are in a location designated by Lessor and comply with Applicable Requirements and the signage criteria established for the Industrial Center by Lessor. The installation of any sign on the Premises by or for Lessee shall be subject to the provisions of Paragraph 7 (Maintenance, Repairs, Utility Installations, Trade Fixtures and Alterations). Unless otherwise expressly agreed herein, Lessor reserves all rights to the use of the roof of the Building, and the right to install advertising signs on the Building, including the roof, which do not unreasonably interfere with the conduct of Lessee's business; Lessor shall be entitled to all revenues from such advertising signs. See Paragraph 57.

35. TERMINATION; MERGER. Unless specifically stated otherwise in writing by Lessor, the voluntary or other surrender of this Lease by Lessee, the mutual termination or cancellation hereof, or a termination hereof by Lessor for Breach by Lessee, shall automatically terminate any sublease or lesser estate in the Premises; provided, however, Lessor shall, in the event of any such surrender, termination or cancellation, have the option to continue any one or all of any existing subtenancies. Lessor's failure within ten (10) days following any such event to make a written election to the contrary by written notice to the holder of any such lesser interest, shall constitute Lessor's election to have such event constitute the termination of such interest.

36. CONSENTS.

(a) Except for Paragraph 33 hereof (Auctions) or as otherwise provided herein, wherever in this Lease the consent of a Party is required to an act by or for the other Party, such consent shall not be unreasonably withheld or delayed. Lessor's actual reasonable costs and expenses (including but not limited to architects', attorneys', engineers' and other consultants' fees) incurred in the consideration of, or response to, a request by Lessee for any Lessor consent pertaining to this Lease or the Premises, including but not limited to consents to an assignment a subletting or the presence or use of a Hazardous Substance, shall be paid by Lessee to Lessor upon receipt of an invoice and supporting documentation therefor. In addition to the deposit described in Paragraph 12.2(e), Lessor may, as a condition to considering any such request by Lessee, require that Lessee deposit with Lessor an amount of money (in addition to the Security Deposit held under Paragraph 5) reasonably calculated by Lessor to represent the cost Lessor will incur in considering and responding to Lessee's request. Any unused portion of said deposit shall be refunded to Lessee without interest. Lessor's consent to any act, assignment of this Lease or subletting of the Premises by Lessee shall not constitute an acknowledgment that no Default or Breach by Lessee of this Lease exists, nor shall such consent be deemed a waiver of any then existing Default or Breach, except as may be otherwise specifically stated in writing by Lessor at the time of such consent.

(b) All conditions to Lessor's consent authorized by this Lease are acknowledged by Lessee as being reasonable. The failure to specify herein any particular condition to Lessor's consent shall not preclude the impositions by Lessor at the time of consent of such further or other conditions as are then reasonable with reference to the particular matter for which consent is being given.

38. QUIET POSSESSION. Upon payment by Lessee of the rent for the Premises and the performance of all of the covenants, conditions and provisions on

Lessee's part to be observed and performed under this Lease, Lessee shall have quiet possession of the Premises for the entire term hereof subject to all of the provisions of this Lease.

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#### 39. OPTIONS.

39.1 DEFINITION. As used in this Lease, the word "OPTION" has the following meaning: (a) the right to extend the term of this Lease or to renew this Lease.

39.2 OPTIONS PERSONAL TO ORIGINAL LESSEE. Each Option granted to Lessee in this Lease is personal to the original Lessee named in Paragraph 1.1 hereof, and cannot be voluntarily or involuntarily assigned or exercised by any person or entity other than said original Lessee while the original Lessee is in full and actual possession of the Premises and without the intention of thereafter assigning or subletting. The Options, if any, herein granted to Lessee are not assignable, either as a part of an assignment of this Lease or separately or apart therefrom, and no Option may be separated from this Lease in any manner, by reservation or otherwise.

39.3 MULTIPLE OPTIONS. In the event that Lessee has any multiple Options to extend or renew this Lease, a later option cannot be exercised unless the prior Options to extend or renew this Lease have been validly exercised.

#### 39.4 EFFECT OF DEFAULT ON OPTIONS.

(a) Lessee shall have no right to exercise an Option, notwithstanding any provision in the grant of Option to the contrary: (i) during the period commencing with the giving of any notice of Default under Paragraph 13.1 and continuing until the noticed Default is cured, or (ii) during the period of time any monetary obligation due Lessor from Lessee is unpaid (without regard to whether notice thereof is given Lessee), or (iii) during the time Lessee is in Breach of this Lease, or (iv) in the event that Lessor has given to Lessee three (3) or more notices of separate Defaults under Paragraph 13.1 during the twelve (12) month period immediately preceding the exercise of the Option, whether or not the Defaults are cured.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 39.4(a).

(c) All rights of Lessee under the provisions of an Option shall terminate and be of no further force or effect, notwithstanding Lessee's due and timely exercise of the Option, if, after such exercise and during the term of this Lease, (i) Lessee fails to pay to Lessor a monetary obligation of Lessee for a period of thirty (30) days after such obligation becomes due (without any necessity of Lessor to give notice thereof to Lessee), or (ii) Lessor gives to Lessee three (3) or more notices of separate Defaults under Paragraph 13.1 during any twelve (12) month period, whether or not the Defaults are cured, or (iii) if Lessee commits a Breach of this Lease.

40. RULES AND REGULATIONS. Lessee agrees that it will abide by, and keep and observe all reasonable rules and regulations ("Rules and Regulations") which Lessor may make from time to time for the management, safety, care, and cleanliness of the grounds, the parking and unloading of vehicles and the preservation of good order, as well as for the convenience of other occupants or tenants of the Building and the Industrial Center and their invitees.

41. SECURITY MEASURES. Lessee hereby acknowledges that the rental payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of the Premises, Lessee, its agents and invitees and their property from the acts of third parties.

42. RESERVATIONS. Lessor reserves the right, from time to time, to grant,

without the consent or joinder of Lessee, such easements, rights of way, utility raceways, and dedications that Lessor deems necessary, and to cause the recordation of parcel maps and restrictions, so long as such easements, rights of way, utility raceways, dedications, maps and restrictions do not reasonably interfere with the use of the Premises by Lessee. Lessee agrees to sign any documents reasonably requested by Lessor to effectuate any such easement rights, dedication, map or restrictions.

43. PERFORMANCE UNDER PROTEST. If at any time a dispute shall arise as to any amount or sum of money to be paid by one Party to the other under the provisions hereof, the Party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment and there shall survive the right on the part of said Party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said Party to pay such sum or any part thereof, said Party shall be entitled to recover such sum or so much thereof as it was not legally required to pay under the provisions of this Lease.

44. AUTHORITY. If either Party hereto is a corporation, trust, or general or limited partnership, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on its behalf. If Lessee is a corporation, trust or partnership, Lessee shall, within thirty (30) days after request by Lessor, deliver to Lessor evidence satisfactory to Lessor of such authority.

45. CONFLICT. Any conflict between the printed provisions of this Lease and the typewritten or handwritten provisions shall be controlled by the typewritten or handwritten provisions.

46. OFFER. Preparation of this Lease by either Lessor or Lessee or Lessor's agent or Lessee's agent and submission of same to Lessee or Lessor shall not be deemed an offer to lease. This Lease is not intended to be binding until executed and delivered by all Parties hereto.

47. AMENDMENTS. This Lease may be modified only in writing, signed by the parties in interest at the time of the modification. The Parties shall amend this Lease from time to time to reflect any adjustments that are made to the Base Rent or other rent payable under this Lease. As long as they do not materially change Lessee's obligations hereunder, Lessee agrees to make such reasonable non-monetary modifications to this Lease as may be reasonably required by an institutional insurance company or pension plan Lender in connection with the obtaining of normal financing or refinancing of the property of which the Premises are a part.

48. MULTIPLE PARTIES. Except as otherwise expressly provided herein, if more than one person or entity is named herein as either Lessor or Lessee, the obligations of such multiple parties shall be the joint and several responsibility of all persons or entities named herein as such Lessor or Lessee.

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LESSOR AND LESSEE HAVE CAREFULLY READ AND REVIEWED THIS LEASE AND EACH TERM AND PROVISION CONTAINED HEREIN, AN BY THE EXECUTION OF THIS LEASE SHOW THEIR INFORMED AND VOLUNTARY CONSENT THERETO. THE PARTIES HEREBY AGREE THAT, AT THE TIME THIS LEASE IS EXECUTED, THE TERMS OF THIS LEASE ARE COMMERCIALY REASONABLE AND EFFECTUATE THE INTENT AND PURPOSE OF LESSOR AND LESSEE WITH RESPECT TO THE PREMISES.

IF THIS LEASE HAS BEEN FILLED IN, IT HAS BEEN PREPARED FOR YOUR ATTORNEY'S REVIEW AND APPROVAL. FURTHER, EXPERTS SHOULD BE CONSULTED TO EVALUATE THE CONDITION OF THE PROPERTY FOR THE POSSIBLE PRESENCE OF ASBESTOS, UNDERGROUND STORAGE TANKS OR HAZARDOUS SUBSTANCES. NO REPRESENTATION OR RECOMMENDATION IS MADE BY THE AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION OR BY THE REAL ESTATE BROKERS OR THEIR CONTRACTORS, AGENTS OR EMPLOYEES AS TO THE LEGAL SUFFICIENCY, LEGAL

EFFECT, OR TAX CONSEQUENCES OF THIS LEASE OR THE TRANSACTION TO WHICH IT RELATES; THE PARTIES SHALL RELY SOLELY UPON THE ADVICE OF THEIR OWN COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS LEASE. IF THE SUBJECT PROPERTY IS IN A STATE OTHER THAN CALIFORNIA, AN ATTORNEY FROM THE STATE WHERE THE PROPERTY IS LOCATED SHOULD BE CONSULTED.

The parties hereto have executed this Lease at the place and on the dates specified above their respective signatures.

Executed at: \_\_\_\_\_ Executed at: \_\_\_\_\_

on: \_\_\_\_\_ on: \_\_\_\_\_

By LESSOR: \_\_\_\_\_ By LESSEE: \_\_\_\_\_  
Richard and Donna Piazza, Trustees of Skechers U.S.A., Inc.  
\_\_\_\_\_  
the Piazza Family Trust  
\_\_\_\_\_

By: /s/ Richard Piazza \_\_\_\_\_ By: /s/ Roger A. Moss \_\_\_\_\_

Name Printed: Richard Piazza, Trustee \_\_\_\_\_ Name Printed: Roger A. Moss \_\_\_\_\_

Title: Owner \_\_\_\_\_ Title: Director of Real Estate \_\_\_\_\_

By: Donna Piazza \_\_\_\_\_ By: \_\_\_\_\_

Name Printed: Donna Piazza, Trustee \_\_\_\_\_ Name Printed: \_\_\_\_\_

Title: Owner \_\_\_\_\_ Title: \_\_\_\_\_

Address: 2612 Pine \_\_\_\_\_ Address: \_\_\_\_\_

Manhattan Beach CA 90266 \_\_\_\_\_

Telephone: (310) 545-4203 \_\_\_\_\_ Telephone: ( ) \_\_\_\_\_

Facsimile: ( ) \_\_\_\_\_ Facsimile: ( ) \_\_\_\_\_

BROKER: \_\_\_\_\_ BROKER: \_\_\_\_\_  
Executed at: \_\_\_\_\_ Executed at: \_\_\_\_\_

on: \_\_\_\_\_ on: \_\_\_\_\_

by: \_\_\_\_\_ by: \_\_\_\_\_

Name Printed: \_\_\_\_\_ Name Printed: \_\_\_\_\_

Title: \_\_\_\_\_ Title: \_\_\_\_\_

Address: \_\_\_\_\_ Address: \_\_\_\_\_



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Telephone: ( ) Telephone: ( )  
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Facsimile: ( ) Facsimile: ( )  
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NOTE: These forms are often modified to meet changing requirements of law and needs of the industry. Always write or call to make sure you are utilizing the most current form: AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION, 345 So. Figueroa St., M-1, Los Angeles, CA 90071, (213) 687-8777.

Initials: DP  
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MULTI-TENANT--MODIFIED NET RAM  
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ADDENDUM TO STANDARD INDUSTRIAL/COMMERCIAL  
MULTI-TENANT LEASE - MODIFIED NET  
BY AND BETWEEN RICHARD AND DONNA PIAZZA,  
TRUSTEES OF THE PIAZZA FAMILY TRUST AND  
SKECHERS U.S.A., INC. ("LESSEE")

This Addendum is attached to and made a part of the Lease dated as of June 12, 1998 by and between the above-named Lessor and Lessee, with regard to the leased premises located at 1112 Manhattan Avenue, Manhattan Beach, California. In the event of a conflict between any provision(s) contained in the Lease and any provisions contained in this Addendum, the provisions of this Addendum shall control.

49. Option to Extend. So long as Lessee is not in default under this Lease, or the lease for the Upstairs Space (as defined in Paragraph 56), or the right of Lessor to exercise the option to extend this Lease as set forth below is not precluded by the occurrence of one (1) or more of the events set forth in Paragraph 39.4 of the Lease, Lessee will have the option to extend the Original Term of this Lease for an additional period of five (5) years ("Option Period") on the same terms, covenants and conditions of this Lease, except that the Base Rent during the Option Period shall be determined pursuant to Paragraph 50. Lessee will exercise its option by giving Lessor written notice at least one hundred eighty (180) days but not more than two hundred seventy days (270) days prior to the expiration of the Original Term.

50. Rent Increases. Commencing June 14, 1999 and on each June 14 thereafter during the Original Term hereof and the Option Period, the Base Rent shall be increased by four percent (4%) of the Base Rent payable during the prior twelve (12) months.

51. Base Rent Upon Execution. The \$8,487.00 payment upon execution of this Lease represents Base Rent for June 15 through June 30 1998 and the entire month of July 1998.

52. As-Is Condition. Lessor shall deliver the Premises to Lessee, and Lessee shall lease from Lessor the Premises in its "as-is" condition as of the Commencement Date. Lessee shall have no obligation to construct any additional improvements to the Premises, or to repair or clean up any portion of the Premises.

53. Exclusions from Common Area Operating Expenses. Notwithstanding anything to the contrary contained in the Lease, there shall be excluded from Common Area Operating Expenses the following:

(1) Costs incurred in connection with the original construction of the Industrial Center or in connection with any major change in the Industrial

Center, such as adding or deleting floors;

(2) Costs of alterations or improvements to the premises of any lessees of the Building;

(3) Depreciation, interest and principal payments on mortgages, and other debt costs, if any;

(4) Costs for which Lessor is reimbursed by any insurance carrier;

(5) Any bad debt loss, rent loss or reserves for bad debts or rent loss;

(6) Fines, penalties and interest (except as specifically provided in paragraph 19 of this Lease); and

(7) Tax penalties incurred as a result of Lessor's negligence, inability or unwillingness to make payments when due.

In the calculation of Common Area Operating Expenses, it is understood that no expenses shall be charged more than once. If one lessee's use results in higher insurance premiums on the policies maintained by Lessor hereunder, Lessor agrees to provide an equitable proration thereof in billing the Common Area Operating Expenses. Lessor agrees to keep books and records showing the Common Area Operating Expenses in accordance with a system of accounts and account practices consistently maintained on a year-to-year basis, and to provide Lessee with access thereto upon reasonable notice.

54. Notwithstanding any other provision of the Lease or this Addendum, Lessee acknowledges that the retail businesses at the Building engage in the practice of displaying merchandise in the Common Area in front of their respective premises. Lessee further acknowledges that the other lessees' display of their merchandise in the Common Area shall be an acceptable use of the Common Area by other lessee's of the Building and shall not be a breach of Lessor's obligation to operate the Common Area in a neat, clean, good order and condition.

55. Assignment. Notwithstanding the provisions of paragraph 12, no consent from Lessor shall be required for the assignment or subletting of this lease under the following circumstances:

(i) the transfer of stock of Lessee to members of immediate family of a shareholder of Lessee, to a living trust for estate-planning purposes, or by will or intestacy; or

(ii) Lessee sells or offers for sale its voting stock to the public in accordance with the qualifications or registration requirements of the State of California and the Security Act of 1933, as amended.

56. Notwithstanding the foregoing, Lessor and Lessee acknowledge that the parties have entered into a separate Commercial Lease Agreement for that certain portion of the Building commonly known as 1110 Manhattan Avenue, Manhattan Beach, CA ("Upstairs Space").

57. Lessee's Sign. In addition to the obligations of Lessee with respect to the placement of a sign upon the exterior of the Premises ("Lessee's Sign") and Lessee's adherence to the signage criteria established for the Building by Lessor, Lessee's Sign shall conform with the signs of the other retail lessees at the Building.

58. Upstairs Electrical Work. Lessee acknowledges that certain electrical work in the amount of \$5,826.00 was performed by an electrical contractor on behalf of Lessor in the Upstairs Space ("Upstairs Electrical Work"). Lessee paid the electrical contractor directly for the Upstairs Electrical Work. Though payment for the Upstairs Electrical Work was the responsibility of Lessor, Lessee forever releases and discharges Lessor and its successors and assigns from any claim for reimbursement which Lessee has against Lessor for the Upstairs Electrical Work.

59. Restaurant Improvements. Lessee acknowledges that prior to the Commencement Date, Lessor has constructed substantial improvements in the Premises in order

to accommodate a restaurant operator ("Restaurant Improvements"). Lessee shall not during the course of the construction of its Lessee Owned Alterations and/or Utility Installations in the Premises or at any time during the Original Term or Option Period, remove, replace, modify or disturb any of the Restaurant Improvements.

60. Lease Preparation Legal Fees. Lessee acknowledges that Lessor incurred certain legal fees in engaging the law firm of Baker, Burton & Lundy ("BB&L") to prepare a draft of a lease for the Premises ("Draft Lease"). Lessee acknowledges that Lessee shall be responsible for and pay directly to BB&L those specific legal fees incurred by Lessor in connection with the preparation of the Draft Lease, and Lessee forever releases and discharges Lessor and its successors and assigns from any claim for reimbursement for such legal fees paid by Lessee to BB&L with respect to the Draft Lease.

EXHIBIT 10.14

LEASE

between

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA

and

SKECHERS U.S.A., INC.

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Exhibit "A" Premises (Paragraph 2)

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LEASE

1. Parties. This Lease, dated, for reference purposes only, November 21, 1997, is made by and between THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, a New Jersey corporation (herein called "Lessor") and SKECHER'S U.S.A., INC. (herein called "Lessee").

2. Premises. Lessor hereby leases to Lessee and Lessee leases from Lessor for the term, at the rental, and upon all of the conditions set forth herein, that certain real property situated in the County of San Bernardino, State of California, commonly known as 1661 South Vintage Avenue, Ontario, California

consisting of a 127,799 square foot building (including a portion of the Causeway (as defined below)) and adjacent land and more particularly delineated on Exhibit "A" attached hereto and by this reference incorporated herein. Said real property including the land and all improvements therein, is herein called the "Premises."

3. Term.

3.1 Term. The term of this Lease shall be for five (5) years commencing on December 1, 1997 and ending on November 30, 2002, unless sooner terminated pursuant to any provision hereof.

3.2 Delay in Possession. Notwithstanding said commencement date, if for any reason Lessor cannot deliver possession of the Premises to Lessee on said date, Lessor shall not be subject to any liability therefor, nor shall such failure affect the validity of this Lease or the obligations of Lessee hereunder or extend the term hereof, but in such case, Lessee shall not be obligated to pay rent until possession of the Premises is tendered to Lessee; provided, however, that if Lessor shall not have delivered possession of the Premises within sixty (60) days from said commencement date, Lessee may, at Lessee's option, by notice in writing to Lessor within ten (10) days thereafter, cancel this Lease, in which event the parties shall be discharged from all obligations hereunder provided further, however, that if such written notice of Lessee is not received by Lessor within said ten (10) day period, Lessee's right to cancel this Lease hereunder shall terminate and be of no further force or effect.

3.3 Early Possession. If Lessee occupies the Premises prior to said commencement date, such occupancy shall be subject to all provisions hereof, such occupancy shall not advance the termination date, and Lessee shall pay rent for such period at the initial monthly rates set forth below.

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4. Base Rent. Lessee shall pay to Lessor as rent for the Premises, monthly payments of \$36,423.00 ("Base Rent"), in advance, on the first day of each month of the term hereof. Lessee shall pay Lessor upon the execution hereof \$36,423.00 as rent for December 1997. Rent for any period during the term hereof which is for less than one month shall be a pro rata portion of the monthly installment. Rent shall be payable in lawful money of the United States to Lessor at the address stated herein or to such other persons or at such other places as Lessor may designate in writing, without any offset or deduction.

5. Security Deposit. Lessee shall deposit with Lessor upon execution hereof \$72,846.00 as security for Lessee's faithful performance of Lessee's obligations hereunder. If Lessee fails to pay rent or other charges due hereunder, or otherwise defaults with respect to any provision of this Lease, Lessor may use, apply or retain all or any portion of said deposit for the payment of any rent or other charge in default or for the payment of any other sum to which Lessor may become obligated by reason of Lessee's default, or to compensate Lessor for any loss or damage which Lessor may suffer thereby. If Lessor so uses or applies all or any portion of said deposit, Lessee shall within ten (10) days after written demand therefor deposit cash with Lessor in an amount sufficient to restore said deposit to the full amount hereinabove stated and Lessee's failure to do so shall be material breach of this Lease. If the monthly rent shall, from time to time, increase during the term of this Lease, Lessee shall thereupon deposit with Lessor additional security deposit so that the amount of security deposit held by Lessor shall at all times bear the same proportion to current Base Rent as the original security deposit bears to the original monthly rent set forth in Paragraph 4 hereof. Lessor shall not be required to keep said deposit separate from its general accounts. If Lessee performs all of Lessee's obligations hereunder, said deposit, or so much thereof as has not theretofore been applied by Lessor, shall be returned, without payment of interest or other increment for its use, to Lessee (or, at Lessor's option, to the last assignee, if any, of Lessee's interest hereunder) at the expiration of the term hereof, and after Lessee has vacated the Premises. No trust relationship is created herein between Lessor and Lessee with respect to said Security Deposit.

6. Use.

6.1 Use. The Premises shall be used and occupied, subject to the other terms of this Lease, only for warehousing and distribution in any customary manner permitted by applicable law and for no other purpose.

6.2 Compliance with Law. Lessee shall, at Lessee's expense, comply promptly with all applicable statutes, ordinances, rules, regulations, orders, covenants and restrictions of record, and requirements in effect during the term or any part of the term hereof, relating in any manner to the Premises and the occupation and use by Lessee of the Premises. Lessee shall not use nor permit the use of the Premises in any manner

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that will tend to create waste or a nuisance or, if there shall be more than one tenant in the building containing the Premises, shall tend to disturb such other tenants.

6.3 Condition of Premises. Lessee hereby accepts the Premises in their "as is" condition existing as of the Lease commencement date or the date that Lessee takes possession of the Premises, whichever is earlier, subject to all applicable zoning, municipal county and state laws, ordinances and regulations governing and regulating the use of the Premises, and any covenants or restrictions or easements of record, and accepts this Lease subject thereto and to all matters disclosed thereby and by any exhibits attached hereto. Lessee acknowledges that neither Lessor nor Lessor's agent has made any representation or warranty as to the present or future suitability of the Premises for the conduct of Lessee's business.

## 7. Maintenance, Repairs and Alterations.

### 7.1 Lessee's Obligations.

(a) Except to the extent of Lessor's obligations under Paragraph 7.4, below, Lessee shall keep in good order, condition and repair the interior of the Premises and every structural or nonstructural part thereof (whether or not such portion of the Premises requiring repair, or the means of repairing the same are reasonably or readily accessible to Lessee, and whether or not the need for such repairs occurs as a result of Lessee's use, any prior use, the elements or the age of such portion of the Premises) including, without limiting the generality of the foregoing, all plumbing, heating and air conditioning (Lessee shall procure and maintain, at Lessee's expense, an air conditioning system maintenance contract) ventilating, electrical, lighting facilities and equipment within the Premises, fixtures, walls (interior and exterior), ceilings, roofs (interior), floors, windows, doors, plate glass and skylights located within the Premises, and all driveways, parking lots, fences and signs located on the Premises and sidewalks and parkways adjacent to the Premises.

(b) Lessee shall maintain the Premises as provided in Paragraph 7.1(a) and in accordance with the requirements of any covenants or restrictions as may from time to time be applicable to the Premises. Lessee, in keeping the Premises in good order, condition and repair, shall exercise and perform good maintenance practices and any damage or deterioration shall not be deemed "ordinary wear and tear" if the same could have been prevented by good maintenance practice. Lessee's obligations shall include restorations, replacements or renewals when necessary and when determined not to be due to ordinary wear and tear, in order to keep the Premises and all improvements thereon or a part thereof in good order, condition and state of repair. Notwithstanding anything contained in the Lease to the contrary, Lessee shall make all repairs whatsoever on the Premises necessitated by the negligence, misconduct or fault of Lessee, or its agents, licensees or agents.

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7.2 Surrender. On the last day of the term hereof, or on any sooner termination, Lessee shall surrender the Premises to Lessor in the same condition as when received, ordinary wear and tear excepted, clean and free of debris. Lessee shall repair any damage to the Premises occasioned by the installation or removal of Lessee's trade fixtures, furnishings and equipment (including without limitation the following components of Lessee's material handling system: racking, conveyors, mezzanine and related utilities (collectively, "Lessee's Systems")). Notwithstanding anything to the contrary otherwise stated in this Lease, upon termination of this Lease, (a) Lessee shall remove from the Premises Lessee's Systems, and (b) Lessee shall leave the air lines, power panels, electrical distribution systems, mechanical systems, lighting fixtures, air conditioning, plumbing, heating (including space heaters) and fencing on the Premises (other than Lessee's Systems, which shall be removed from the Premises as provided above) in good condition and operating order, and Lessee shall upon



demand pay to Lessor that portion of the cost to restore such items to good condition and operating order as may be reasonably allocable to Lessee's tenancy.

7.3 Lessor's Rights. If Lessee fails to perform Lessee's obligations under this Paragraph 7, or under any other paragraph of this Lease, Lessor may at its option (but shall, not be required to) enter upon the Premises after ten (10) days' prior written notice to Lessee (except in the case of an emergency, in which case no notice shall be required), perform such obligations on Lessee's behalf and put the same in good order, condition and repair, and the cost thereof together with interest thereon at the maximum rate then allowable by law shall become due and payable as additional rental to Lessor together with Lessee's next rental installment.

#### 7.4 Lessor's Obligations.

(a) Except for the obligations of Lessor under Paragraph 9 (relating to destruction of the Premises), under Paragraph 14 (relating to condemnation of the Premises) and Paragraph 7.4(b), it is intended by the parties hereto that Lessor have no obligation, in any manner whatsoever, to repair and maintain the Premises nor the building located thereon nor the equipment therein, whether structural or non structural, all of which obligations are intended to be that of the Lessee under Paragraph 7.1 hereof. Lessee expressly waives the benefit of any statute now or hereinafter in effect which would otherwise afford Lessee the right to make repairs at Lessor's expense or to terminate this Lease because of Lessor's failure to keep the Premises in good order, condition and repair.

(b) Lessor shall replace the roof (exterior only) as necessary and maintain and repair the structural components of the perimeter wall of the Premises, subject to normal wear and tear, provided the need for such replacement, maintenance

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or repair does not arise because of the negligence, misconduct or fault of Lessee, or its agents, licensees or invitees.

#### 7.5 Alterations and Additions.

(a) Lessee shall not without Lessor's prior written consent make any alterations, improvements, additions, or Utility Installations in, on or about the Premises, except for nonstructural alterations not exceeding \$10,000 in cumulative costs during any 12-month period (the "Threshold Amount"). In any event, whether or not in excess of the Threshold Amount, Lessee shall make no change or alteration to the exterior of the Premises nor the exterior of the building(s) on the Premises without Lessor's prior written consent. As used in Paragraph 7.5, the term "Utility Installation" shall mean carpeting, window coverings, air lines, power panels, electrical distribution systems, lighting fixtures, space heaters, air conditioning, plumbing and fencing. Lessor may require Lessee to provide Lessor, at Lessee's sole cost and expense, a lien and completion bond in an amount equal to one and one-half times the estimated cost of such improvements, to insure Lessor against any liability for mechanic's and materialmen's liens and to insure completion of the work. Lessor's consent shall not be required for reconfiguration, relocation or modification to the racking and material handling system, including electrical work related thereto; provided none of such work is structural and all of such work is in the interior of the building on the Premises.

(b) Any alterations, improvements, additions, or Utility Installations made by Lessee during the term of this Lease shall be done in a good and workmanlike manner and of good and sufficient materials, and Lessee shall, within thirty (30) days after completion of such alteration, improvements, addition or Utility Installation, provide Lessor with as-built plans and specifications for same. Notwithstanding anything contained in this Lease to the contrary, Paragraphs 7.5(d)(1)(ii) and (iii) shall apply to non-structural alterations, improvements, additions or Utility Installations (other than racking, shelving and temporary partitions) not exceeding the Threshold Amount.

(c) Any alterations, improvements, additions or Utility Installations in, or about the Premises that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written

form, with proposed detailed plans. If Lessor shall give its consent, the consent shall be conditioned upon satisfaction of all of the requirements set forth in Paragraph 7.5(d), below.

(d) For any additions, alterations, improvements, or Utility Installations requiring Lessor's prior written consent:

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(1) Lessee shall:

(i) Request Lessor's approval in writing at least thirty (30) days prior to proposed construction.

(ii) Employ a California licensed architect contractor and structural engineer in connection with the proposed construction.

(iii) Be fully responsible for the acts of Lessee's consultants, employees, contractors, subcontractors, invitees and agents, and cause them to fully comply with any applicable terms of this Lease and documents referred to by this Lease and all applicable laws, rules and regulations.

(iv) Cause to be obtained an applicable building permit for any and all construction and modifications, and construct the additions and alterations and perform the construction work in accordance with all applicable laws, including without limitation the Americans With Disabilities Act.

(2) Lessee's architect shall:

(i) Be licensed by the State of California.

(ii) Design and specify within the parameters of the building work letter and approved building specifications or have received specific written exceptions from the Lessor.

(iii) Secure Lessor's written approval before submitting plans to the general contractor for bidding or to governmental agencies for approval.

(iv) Secure Lessor's written approval of any changes or alternates to the plans recommended by the general contractor or required by governmental agencies.

(v) Submit a copy of the final application for permit and issued permit to Lessor.

(vi) Incorporate the building standard details supplied by Lessor onto the drawings.

(vii) Submit final plans for Lessor's written approval prior to construction.

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(viii) Be available for final inspection with Lessor at job completion.

(ix) Secure Lessor's written approval of details of any changes in specifications or finishes during construction.

(x) Provide samples and specifications as required by Lessor.

(xi) Sign off on the as-built drawings as the Architect's certification that the improvements have, in fact, been built as per the Architect's design.

(3) Lessee's general contractor and/or subcontractors shall:

(i) Be licensed by the State of California.

(ii) Have substantial experience providing similar quality and quantity of improvements. Work history shall be provided to Lessor prior to being awarded contract.

(iii) Have a bonding capacity equal to or exceeding the valuation of the job. Lessor may, at its sole option, require the job to be bonded.

(iv) Maintain in full force and effect, throughout the duration of its performance under the contract with the Lessee, a Worker's Compensation insurance policy and a Commercial General Liability insurance policy issued by an insurer satisfactory to Lessor with liability coverage of not less than \$1,000,000.00 for personal injury and \$500,000.00 to cover property damage. The Commercial General Liability insurance policy shall include assumption of contractual liability. Certificates of insurance containing a thirty (30) day cancellation clause shall be furnished to Lessor prior to commencement of performance under the construction contract naming Lessor (The Prudential Insurance Company of America) and its managing agent as additional insureds.

(v) Provide a construction schedule to Lessor prior to commencement of work and weekly written progress reports.

(vi) Warrant the Contractor's work and that of the Contractor's subcontractors, for a minimum of one (1) year.

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(vii) Provide Lessor with as-built drawings of all improvements.

(e) All approvals by Lessor, as provided for in this Paragraph 7.5, shall not be unreasonably withheld. All requests to be submitted to Lessor shall be submitted through Lessor's managing agent. If Lessor shall give its consent, the consent shall be deemed conditioned upon the compliance by Lessee in a prompt and expeditious manner of all conditions of all permits obtained pursuant to Paragraph 7.5(d), above.

(f) Lessee shall pay, when due, all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use in the Premises, which claims are or may be secured by any mechanics' or materialmen's lien against the Premises or any interest therein. Lessee shall give Lessor not less than thirty (30) days' notice prior to the commencement of any work in the Premises, and Lessor shall have the right to post notices of non-responsibility in or on the Premises as provided by law. If Lessee shall in good faith, contest the validity of any such lien, claim or demand, then Lessee shall at its sole expense defend itself and Lessor against the same and shall pay and satisfy any such adverse judgment that may be rendered thereon before the enforcement thereof against the Lessor or the Premises, upon the condition that if Lessor shall require, Lessee shall furnish to Lessor a surety bond satisfactory to Lessor in an amount equal to such contested lien claim or demand indemnifying Lessor against liability for the same and holding the Premises free from the effect of such lien or claim. In addition, Lessor may require Lessee to pay Lessor's attorneys fees and costs in participating in such action if Lessor shall decide it is in its best interest to do so; provided Lessor agrees that Lessee shall not be obligated to pay such fees pursuant to this sentence with respect to any period in which both (a) Lessee has provided the surety bond required above, and (b) Lessor has not been named in such action.

(g) Unless otherwise agreed in writing, Lessor may require that any or all alterations, improvements, additions or Utility Installations be removed by the expiration or earlier termination of this Lease, notwithstanding their installation may have been consented to by Lessor, and that the Premises be restored to their prior condition. Should Lessee make any alterations, improvements, additions or Utility Installations without the prior approval of Lessor, Lessor may require that Lessee remove any or all of the same.

(h) Unless Lessor requires their removal, as set forth in Paragraph 7.5(g), all alterations, improvements, additions and Utility Installations (whether or not such Utility Installations constitute trade fixtures of Lessee), which may be made on the Premises, shall become the property of Lessor and remain upon

and be surrendered with the Premises at the expiration of the term. Notwithstanding the provisions of this Paragraph 7.5(h), Lessee's machinery and equipment other than that which is affixed to the Premises so that it cannot be removed without material damage to the Premises, shall remain the property of Lessee and may be removed by Lessee subject to the provisions of Paragraph 7.2.

8. Insurance: Indemnity.

(a) Lessee hereby agrees to indemnify, defend and hold harmless Lessor, its successors, assigns, subsidiaries, directors, officers, agents and employees from and against any and all damage, loss, liability or expense including, but not limited to, attorney's fees and legal costs suffered by same directly or by reason of any claim, suit or judgment brought by or in favor of any person or persons for damage, loss or expense due to, but not limited to, bodily injury, including death resulting anytime therefrom and property damage sustained by such person or persons which arises out of, is occasioned by or in any way attributable to the use or occupancy of the Premises by the Lessee, the acts or omission of the Lessee, its agents, employees or any other contractors brought onto said Premises by the Lessee, or any breach or default in the performance of any obligation on Lessee's part to be performed under the terms of this Lease, except to the extent caused by the sole gross negligence or willful misconduct of Lessor, its employees, and agents. If any action or proceeding is brought against Lessor by reason of any such claim, Lessee, upon notice from Lessor, shall defend same at Lessee's expense by counsel satisfactory to Lessor. Such loss or damage shall include, but not be limited to, any injury or damage to Lessor's personnel (including death resulting anytime therefrom) on the Premises. Lessor shall not be liable for any damages arising from any act or neglect of any other tenant if any, of the building or industrial park in which the Premises are located. Lessee agrees that the obligations assumed herein shall survive the termination of this Lease.

(b) Lessee hereby agrees to maintain in full force and effect at all times during the term of this Lease, at Lessee's own expense, for the protection of Lessee, Lessor and Lessor's property manager, as their interest may appear, policies of insurance issued by a responsible carrier or carriers to Lessor which afford the following coverages:

(i) Workers' Compensation with statutory limits.

(ii) Employers' Liability insurance with the following minimum limits:

<TABLE>	
<S>	<C>
Bodily injury by disease per person	\$1,000,000
Bodily injury by accident policy limit	\$1,000,000
Bodily injury by disease policy limit	\$1,000,000
</TABLE>	

(iii) Property insurance on a special causes of loss insurance form covering any and all personal property of Lessee including but not limited to improvements, betterments, furniture, fixtures, Utility Installations, and equipment in an amount not less than their full replacement cost, with a deductible not to exceed \$10,000. This policy should contain a waiver of subrogation.

(iv) Commercial General Liability Insurance including Broad Form Property Damage and Contractual Liability with the following minimum limits:

<TABLE>	
<S>	<C>
General Aggregate	\$2,000,000
Products/Completed Operations Aggregate	\$2,000,000
Each Occurrence	\$1,000,000
Personal & Advertising Injury	\$1,000,000
Medical Payments	\$5,000 per person

</TABLE>

(v) Umbrella/Excess Liability on a following form basis with the following minimum limits:

<TABLE>

<S>	<C>
General Aggregate	\$10,000,000
Each Occurrence	\$10,000,000

</TABLE>

The limits of said insurance in this Paragraph 8(b)(i) shall not however, limit the liability of Lessee hereunder.

(c) If Lessor is providing property insurance on the Premises, then Lessor shall, at all times during the term of this Lease, maintain the following insurance:

(i) a policy or policies of all-risk property insurance, issued by and binding upon some solvent insurance company, insuring for the full replacement cost of the building on the Premises. Lessor shall not be obligated to insure, and shall not assume any liability or risk of loss for, any of Lessee's furniture, equipment, machinery, goods, supplies, utility installations, improvements, or alterations upon the Premises. This policy shall contain an agreed amount endorsement and be written with no coinsurance. Lessor may, but shall not be obligated to, obtain earthquake and flood insurance.

(ii) Rent insurance on an all-risk basis in an amount equal to all that is called for under Paragraph 4 of this Lease (Base Rent and any

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additional rents payable under this Lease including tax and insurance costs) for a period of at least twelve (12) months commencing with the date of loss.

(iii) Boiler and machinery insurance in an amount satisfactory to Lessor on a comprehensive coverage form.

Lessor may elect to have reasonable deductibles in connection with the insurance specified in Paragraph 8(c), and Lessee shall be liable for such deductible amount.

(d) The Lessee shall deliver to Lessor at least thirty (30) days prior to the time such insurance is first required to be carried by Lessee, and thereafter at least thirty (30) days prior to expiration of such policy, certificates of insurance evidencing the above coverage with limits not less than those specified above. Insurance required hereunder shall be in companies holding a "General Policyholders Rating" of at least A-VIII as set forth in the most current issue of "A.M. Best's Insurance Guide". Such Certificates with the exception of Worker's Compensation shall name Lessor, its subsidiaries, directors, agents and employees, and its property manager as additional insureds and shall expressly provide that the interest of same herein shall not be affected by a breach by Lessee of any insurance policy provision for which such Certificates evidence coverage. Further, all Certificates shall expressly provide that no less than thirty (30) days prior written notice shall be given to Lessor in the event of material alteration to or cancellation of the coverage evidenced by such Certificates.

(e) Upon demand Lessee shall provide Lessor, at Lessee's expense, with such increased amount of existing insurance and such other insurance coverage in such limits as Lessor may require in its sole judgement to afford Lessor adequate protection.

(f) If, on account of the failure of Lessee to comply with the foregoing provisions, Lessor is adjudged a co-insurer by the insurance carrier, then any loss or damage Lessor shall sustain by reason thereof shall be borne by Lessee and shall be immediately paid by Lessee upon receipt of bill thereof and evidence of such loss.

(g) Lessor makes no representation that the limits of liability

specified to be carried by Lessee under the term of this Lease are adequate to protect Lessee against Lessee's undertaking under this Paragraph 8 and in the event Lessee believes that any such insurance coverage called for under this Lease is insufficient, Lessee shall provide, at its own expense, such additional insurance as Lessee deems adequate.

(h) Anything in this Lease to the contrary notwithstanding, Lessor and Lessee hereby waive and release each other of and from any and all rights of

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recovery, claims, action or cause of action, against each other, their agents, officers and employees, for any loss or damage that may occur to the Premises, improvements to the building of which the Premises are a part, personal property (building contents) within the building on the Premises, any furniture, equipment, machinery, goods or supplies not covered by this Lease which Lessee may bring or obtain upon the Premises or any additional improvements which Lessee may construct on the Premises, by reason of fire, the elements or any other cause which could be insured against under the terms of all risk property insurance policies, regardless of cause or origin, including negligence of Lessor or Lessee and their agents, officers and employees. Because this Paragraph will preclude the assignment of any claim mentioned in it by way of subrogation (or otherwise) to an insurance company (or any other person) each party to this Lease agrees immediately to give to each insurance company, written notice of the terms of the mutual waivers contained in this Paragraph, and to have the insurance policies properly endorsed if necessary to prevent the invalidation of the insurance coverages by reason of the mutual waivers contained in this Paragraph. Lessee also waives and releases Lessor, its agents, officers and employees of and from any and all rights of recovery, claim, action or cause of action for any loss or damage insured against under any other policies of insurance carried by Lessee.

(i) Lessee shall pay to Lessor during the term hereof, additional rent in the amount of any premiums for the insurance obtained under Paragraphs 8(c)(i), 8(c)(ii), and 8(c)(iii) and any other insurance which Lessor or Lessor's lender deems necessary for the Premises and the amount of any deductibles paid by Lessor under such policies. If Lessor elects to self-insure or includes the Premises under blanket insurance policies covering multiple properties, then Lessee's reimbursement obligation hereunder shall include the portion of the reasonable cost of such self-insurance or blanket insurance that is allocated to the Premises. Lessee shall pay any such premiums to Lessor within thirty (30) days after receipt by Lessee of a copy of the premiums statement or other evidence of the amount due. If the insurance policies maintained hereunder cover other improvements in addition to the Premises, Lessor shall also deliver to Lessee a statement of the amount of such premiums attributable to the Premises and showing in reasonable detail the manner in which such amount was computed. If the term of this Lease shall not expire concurrently with the expiration of the period covered by such insurance, Lessee's liability for premiums shall be prorated on an annual basis.

(j) Lessor may also maintain commercial general liability insurance in addition to, and not in lieu of, the commercial general liability insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein. If Lessor maintains such insurance, Lessee shall pay to Lessor during the term of this Lease additional rent in the amount of any premiums for such insurance in the same manner as provided in Paragraph 8(i). All insurance to be carried by Lessee shall be

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primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only.

(k) Lessor shall not be liable for injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessee's employees, contractors, invitees, customers, or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, air conditioning or lighting fixtures, or from any other cause, whether said injury or damage results from conditions arising upon the Premises or upon other portions of the building of which the Premises are a part, from other sources or places, and regardless of whether the cause of such damage or injury or the

means of repairing the same is accessible or not. Lessor shall not be liable for any damages arising from any act or neglect of any other tenant or Lessor or the failure by Lessor to enforce the provisions of any other lease in the Industrial Center. Notwithstanding Lessor's negligence or breach of this Lease, Lessor shall under no circumstances be liable for injury to Lessee's business or for any loss of income or profit therefrom.

## 9. Damage or Destruction.

### 9.1 Definitions.

(a) "Premises Partial Damage" shall herein mean damage or destruction to the Premises to the extent that the cost of repair is less than 50% of the then replacement cost of the Premises. "Premises Building Partial Damage" shall herein mean damage or destruction to the building of which the Premises are a part to the extent that the cost of repair is less than 50% of the then replacement cost of such building as a whole.

(b) "Premises Total Destruction" shall herein mean damage or destruction to the Premises to the extent that the cost of repair is 50% or more of the then replacement cost of the Premises. "Premises Building Total Destruction" shall herein mean damage or destruction to the building of which the Premises are a part to the extent that the cost of repair is 50% or more of the then replacement cost of such building as a whole.

(c) "Insured Loss" shall herein mean damage or destruction which was caused by an event required to be covered by the insurance described in Paragraph 8.

9.2 Partial Damage - Insured Loss. Subject to the provisions of Paragraphs 9.4, 9.5 and 9.6, if at any time during the term of this Lease there is damage

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which is an Insured Loss and which falls into the classification of Premises Partial Damage or Premises Building Partial Damage, then Lessor shall, at Lessor's expense, repair such damage, but not Lessee's fixtures, equipment or tenant improvements unless the same have become a part of the Premises pursuant to Paragraph 7.5 hereof as soon as reasonably possible and this Lease shall continue in full force and effect. Notwithstanding the above, if the insurance proceeds received by Lessor are not sufficient to effect such repair, Lessor shall give notice to Lessee of the amount required in addition to the proceeds to effect such repair. Lessee shall contribute the required amount to Lessor within ten days after Lessee has received notice from Lessor of the shortage in the insurance. When Lessee shall contribute such amount to Lessor, Lessor shall make such repairs as soon as reasonably possible and this Lease shall continue in full force and effect. Lessee shall in no event have any right to reimbursement for any such amounts so contributed.

9.3 Partial Damage - Uninsured Loss. Subject to the provisions of Paragraphs 9.4, 9.5 and 9.6, if at any time during the term of this Lease there is damage which is not an Insured Loss and which falls within the classification of Premises Partial Damage or Premises Building Partial Damage, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessee's expense), Lessor may at Lessor's option either (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect or (ii) give written notice to Lessee within thirty (30) days after the date of the occurrence of such damage of Lessor's intention to cancel and terminate this Lease, as of the date of the occurrence of such damage. In the event Lessor elects to give such notice of Lessor's intention to cancel and terminate this Lease, Lessee shall have the right within thirty (30) days after the receipt of such notice to give written notice to Lessor of Lessee's intention to repair such damage at Lessee's expense, without reimbursement from Lessor, in which event this Lease shall continue in full force and effect, and Lessee shall proceed to make such repairs as soon as reasonably possible. If Lessee does not give such notice within such 10-day period this Lease shall be canceled and terminated as of the date of the occurrence of such damage.

9.4 Total Destruction. If at any time during the term of this Lease there is damage, whether or not an Insured Loss, (including destruction required by any authorized public authority), which falls into the classification of

Premises Total Destruction or Premises Building Total Destruction, this Lease shall automatically terminate as of the date of such total destruction.

#### 9.5 Damage Near End of Term.

(a) If at any time during the last six months of the term of this Lease there is damage, whether or not an Insured Loss, which falls within the classification of the Premises Partial Damage, Lessor may at Lessor's option cancel and terminate this

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Lease as of the date of occurrence of such damage by giving written notice to Lessee of Lessor's election to do so within 30 days after the date of occurrence of such damage.

(b) Notwithstanding Paragraph 9.5(a) in the event that Lessee has an option to extend or renew this Lease, and the time within which said option may be exercised has not yet expired, Lessee shall exercise such option, if it is to be exercised at all, no later than 20 days after the occurrence of an Insured Loss falling with the classification of Premises Partial Damage during the last six months of the term of this Lease. If Lessee duly exercises such option during said 20 day period, Lessor shall, at Lessor's expense, repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect, provided Lessee first deposits with Lessor any shortfall in necessary funds. If Lessee fails to exercise such option during said 20 day period, then Lessor may at Lessor's option terminate and cancel this Lease as of the expiration of said 20 day period by giving written notice to Lessee of Lessor's election to do so within 10 days after the expiration of said 20 day period, notwithstanding any term or provision in the grant of option to the contrary.

#### 9.6 Abatement of Rent; Lessee's Remedies.

(a) In the event of damage described in Paragraphs 9.2, 9.3 or 9.5 and Lessor or Lessee repairs or restores the Premises pursuant to the provisions of Paragraph 9, the rent payable hereunder for the period during which such damage, repair or restoration continues shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired. Except for abatement of rent, if any, Lessee shall have no claim against Lessor for any damage suffered by reason of any such damage, destruction, repair or restoration.

(b) If Lessor shall be obligated to repair or restore the Premises under the provisions of Paragraph 9 and shall not commence such repair or restoration within 90 days after such obligations shall accrue, Lessee may at Lessee's option cancel and terminate this Lease by giving Lessor written notice of Lessee's election to do so at any time prior to the commencement of such repair or restoration. In such event this Lease shall terminate as of the date of such notice.

9.7 Termination - Advance Payments. Upon termination of this Lease pursuant to Paragraph 9, an equitable adjustment shall be made concerning advance rent and any advance payments made by Lessee to Lessor. Lessor shall, in addition, return to Lessee so much of Lessee's security deposit as has not theretofore been applied by Lessor.

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9.8 Waiver. Lessor and Lessee waive the provisions of any statutes which relate to termination of leases when leased property is destroyed and agree that such event shall be governed by the terms of this Lease.

9.9 Causeway. Notwithstanding anything to the contrary in this Lease, Lessor shall have no obligation to repair, restore or reconstruct any portion of the Causeway.

#### 10. Real Property Taxes.

10.1 Payment of Taxes. Lessee shall pay the real property tax, as defined in Paragraph 10.2, applicable to the Premises during the term of this Lease. All such payments shall be made at least ten (10) days prior to the delinquency date of such payment. Lessee shall promptly furnish Lessor with satisfactory evidence that such taxes have been paid. If any such taxes paid by Lessee shall cover any



period of time prior to or after the expiration of the term hereof, Lessee's share of such taxes shall be equitably prorated to cover only the period of time within the tax fiscal year during which this Lease shall be in effect, and Lessor shall reimburse Lessee to the extent required. If Lessee shall fail to pay any such taxes, Lessor shall have the right to pay the same, in which case Lessee shall repay such amount to Lessor with Lessee's next rent installment together with interest at the maximum rate then allowable by law.

10.2 Definition of "Real Property Tax". As used herein, the term "real property tax" shall include any form of real estate tax or assessment, general, special, ordinary or extraordinary, and any license fee, commercial rental tax, improvement bond or bonds, levy or tax (other than inheritance, personal income or estate taxes) imposed on the Premises by any authority having the direct or indirect power to tax, including any city, state or federal government, or any school, agricultural, sanitary, fire, street, drainage or other improvement district thereof, as against any legal or equitable interest of Lessor in the Premises or in the real property of which the Premises are a part, as against Lessor's right to rent or other income therefrom, and as against Lessor's business of leasing the Premises. The term "real property tax" shall also include any tax, fee, levy, assessment or charge (a) in substitution of, partially or totally, any tax, fee, levy, assessment or charge hereinabove included within the definition of "real property tax," or (b) the nature of which was hereinbefore included within the definition of "real property tax," or (c) which is imposed for a service or right not charged prior to June 1, 1978, or, if previously charged, has been increased since June 1, 1978, or (d) which is imposed as a result of a transfer, either partial or total, of Lessor's interest in the Premises or which is added to a tax or charge hereinbefore included within the definition of real property tax by reason of such transfer, or (e) which is imposed by reason of this transaction, any modifications or changes hereto, or any transfers hereof.

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10.3 Joint Assessment. If the Premises are not separately assessed, Lessee's liability shall be an equitable proportion of the real property taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available. Lessor's reasonable determination thereof, in good faith, shall be conclusive.

10.4 Additional Provisions Regarding Real Property Taxes. Lessor shall have the option to pay the real property taxes, and in such case, Lessee shall, as additional rent for the Premises, pay for cost of all real property taxes paid hereunder. If Lessor pays the real property taxes, Lessee shall, within ten (10) days following demand by Lessor, reimburse Lessor for the cost of the real property taxes so paid. Lessor shall have the right to contest or appeal any real property taxes or assessments applicable to the Premises and to seek a reduction in the assessed valuation of the Premises (collectively, "Tax Contests"). Any refund of real property taxes resulting from any such Tax Contest shall be applied first to reimburse Lessor for its costs and expenses in connection with the Tax Contest (including, without limitation attorneys' fees and the costs of consultants) (collectively, the "Tax Contest Costs") and then, out of and to the extent of the balance of such refund, Lessor shall reimburse to Lessee the portion of such reduction attributable to the Premises and the term of this Lease, if previously paid by Lessee. Lessor shall equitably allocate the Tax Contest Costs between those years covered by the Tax Contest that are outside of the term of this Lease and those years covered by the Tax Contest that are within the term of this Lease.

#### 10.5 Personal Property Taxes.

(a) Lessee shall pay prior to delinquency all taxes assessed against and levied upon trade fixtures, furnishings, equipment and all other personal property of Lessee contained in the Premises or elsewhere. When possible, Lessee shall cause said trade fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor.

(b) If any of Lessee's said personal property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee within 10 days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. Utilities. Lessee shall pay for all water, gas, heat, light, power, telephone and other utilities and services supplied to the Premises, together with any taxes thereon. If any such services are not separately metered to Lessee, Lessee shall pay a reasonable proportion to be determined by Lessor of all charges jointly metered with other premises.

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12. Assignment and Subletting.

12.1 Lessor's Consent Required. Lessee shall not voluntarily or by operation of law assign, transfer, mortgage, sublet, or otherwise transfer or encumber all or any part of Lessee's interest in this Lease or in the Premises, without Lessor's prior written consent, which Lessor shall not unreasonably withhold. Lessor shall respond to Lessee's request for consent hereunder in a timely manner and any attempted assignment, transfer, mortgage, encumbrance or subletting without such consent shall be void, and shall constitute a noncurable breach of this Lease, without the need for notice to Lessee under Paragraph 13.1.

12.2 Procedure. If at any time or from time to time during the term of this Lease, Lessee desires to assign or sublet all or any part of Lessee's interest in this Lease or in the Premises, Lessee shall give prior written notice to Lessor setting forth the terms of the proposed assignment or subletting and the space so proposed to be assigned or sublet. Lessor shall have the option, exercisable by notice given to Lessee within twenty (20) days after Lessee's notice is given, either to sublet from Lessee such space at the rental and other terms set forth in Lessee's notice, or if the proposed subletting is for the entire Premises for the balance of the term of the Lease, to terminate this Lease. If Lessor does not exercise such option and Lessor grants its consent to the proposed assignment or sublease as provided in Paragraph 12.1, Lessee shall be free to assign or sublet such space to any third party. Such assignment or sublease shall be subject to, without limitation, all the conditions in Paragraph 12 and the following conditions:

(a) The assignment or sublease shall be on the terms set forth in the notice given to Lessor. Any subsequent changes or modifications will require Lessor's prior written consent

(b) Lessee acknowledges that Lessor's agreement to lease these Premises to Lessee at the rent and terms stated herein is made in material reliance upon Lessor's evaluation of this particular Lessee's background, experience and ability, as well as the nature of the use of the Premises by this Lessee as set forth in Paragraph 6. In the event that Lessee shall request Lessor's written consent to assign or sublease the Premises as required in Paragraphs 12.1 and 12.2 hereof, then each such request for consent shall be accompanied by the following:

(i) Financial statements of the proposed assignee or sublessee;

(ii) A statement of the specific uses for which the Premises will be utilized by the proposed assignee or sublessee; and

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(iii) Preliminary plans prepared by an architect or civil engineer for all alterations to the Premises that are contemplated to be made by Lessee, the proposed assignee or sublessee.

(c) No assignment or sublease shall be valid and no assignee or sublessee shall take possession of the Premises assigned or subleased until an executed counterpart of such assignment or sublease has been delivered to Lessor.

(d) No sublessee or assignee shall have a right further to sublet or assign.

(e) 50% (after deduction of reasonable real estate brokerage commission paid by Lessee) of any sums or other economic consideration received by Lessee as a result of such assignment or subletting (except rental or other payments received which are attributable to amortization of the cost of

leasehold improvements other than building standard tenant improvements made to the assigned or sublet portion of the Premises by Lessor) whether denominated rentals under the assignment or sublease or otherwise, which exceed, in the aggregate, the total sums which Lessee is obligated to pay Lessor under this Lease (prorated to reflect obligations allocable to that portion of the Premises subject to such assignment or sublease) shall be payable to Lessor as additional rental under this Lease without affecting or reducing any other obligation of Lessee hereunder. In the event of subletting of only a portion of the Premises, in calculating whether the rent received by Lessee exceeds the rent payable under this Lease, the rent payable under the Lease shall be prorated according to the square footage involved in order to reflect the rent applicable to the space sublet.

### 12.3 Lessees Other Than Individuals.

(a) If Lessee is a partnership, a transfer of any interest of a general partner, a withdrawal of any general partner from the partnership, or the dissolution of the partnership, shall be deemed to be an assignment of this Lease.

(b) If Lessee is a corporation, unless Lessee is a public corporation whose stock is regularly traded on a national stock exchange, or is regularly traded in the over-the-counter market and quoted on NASDAQ, any sale or other transfer of a percentage of capital stock of Lessee which results in a change of controlling persons, or the sale or other transfer of substantially all of the assets of Lessee, shall be deemed to be an assignment of this Lease.

12.4 Lessee Affiliate. Notwithstanding the provisions of Paragraph 12.1 hereof, Lessee may assign or sublet the Premises, or any portion thereof, without Lessor's consent, to any corporation which controls, is controlled by or is under common control with Lessee, or to any corporation resulting from the merger or

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consolidation with Lessee, or to any person or entity which acquires all the assets of Lessee as a going concern of the business that is being conducted on the Premises, provided that (a) the transferee has a net worth, after the assignment or sublet, which is equal to or greater than the lower of (i) the net worth of Lessee at the date of this Lease and (ii) the net worth of Lessee immediately prior to the transfer; (b) the transferee assumes, in full, the obligations of Lessee under this Lease; and (c) a copy of the document effecting the sublet and evidencing the transferee's assumption of Lessee's obligations hereunder is promptly delivered to Lessor. Any such assignment shall not, in any way, affect or limit the liability of Lessee under the terms of this Lease even if after such assignment or subletting the terms of this Lease are materially changed or altered without the consent of Lessee, the consent of whom shall not be necessary.

12.5 No Release of Lessee. Regardless of Lessor's consent, any subletting or assignment shall not (a) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (b) release Lessee of any of Lessee's obligations hereunder or (c) alter the primary liability of Lessee to pay the rent and to perform all other obligations to be performed by Lessee hereunder. The acceptance of rent by Lessor from any other person shall not be deemed to be a waiver by Lessor of any provision hereof or any default by Lessee. Consent to one assignment or subletting shall not be deemed consent to any subsequent assignment or subletting. In the event of default by any assignee of Lessee or any successor of Lessee, in the performance of any of the terms hereof, Lessor may proceed directly against Lessee without the necessity of exhausting remedies against said assignee. Lessor may consent to subsequent assignments or subletting of this Lease or amendments or modifications to this Lease with assignees of Lessee, without notifying Lessee, or any successor of Lessee, and without obtaining its or their consent thereto and such action shall not relieve Lessee of liability under this Lease.

12.6 Assignment to Lessor. Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all rentals and income arising from any sublease heretofore or hereafter made by Lessee, and Lessor may collect such rent and income and apply same toward Lessee's obligations under this Lease; provided however, that until a default shall occur in the performance of Lessee's obligations under this Lease, and subject to Paragraph 12.2(e) Lessee may receive, collect and enjoy the rents accruing under such sublease. Lessor shall

not, by reason of this or any other assignment of such sublease to Lessor nor by reason of the collection of the rents from a sublessee, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee under such sublease. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice from Lessor stating that a default exists in the performance of Lessee's obligations under this Lease, to pay to Lessor the rents due and to become due under the sublease. Lessee agrees that such sublessee shall have the right to rely upon any such statement and request from Lessor, and that such sublessee shall pay such rents to Lessor without

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any obligation or right to inquire as to whether such default exists and notwithstanding any notice from or claim from Lessee to the contrary. Lessee shall have no right or claim against such sublessee or Lessor for any such rents so paid by said sublessee to Lessor.

12.7 Attorney's Fees. In the event Lessee shall assign or sublet the Premises or request the consent of Lessor to any assignment or subletting or if Lessee shall request the consent of Lessor for any act Lessee proposes to do, then Lessee shall pay Lessor's reasonable attorneys' fees incurred in connection therewith, such attorneys' fees not to exceed \$350.00 for each such request. Notwithstanding the foregoing, the parties agree that a payment of \$750.00 is a reasonable fee for Lessor's, review of Lessee's request to assign or sublease.

### 13. Defaults: Remedies.

13.1 Defaults. The occurrence of any one or more of the following events shall constitute a material default and breach of this Lease by Lessee:

(a) The vacating or abandonment of the Premises by Lessee.

(b) The failure by Lessee to make any payment of rent or any other payment required to be made by Lessee hereunder, as and when due, where such failure shall continue for a period of three days after written notice thereof from Lessor to Lessee. In the event that Lessor serves Lessee with a Notice to Pay Rent or Quit pursuant to applicable Unlawful Detainer statutes, such Notice to Pay Rent or Quit shall also constitute the notice required by this subparagraph.

(c) The failure by Lessee to observe or perform any of the covenants, conditions or provisions of this Lease to be observed or performed by Lessee, other than described in paragraph (b) above, where such failure shall continue for a period of 30 days after written notice thereof from Lessor to Lessee; provided, however, that if the nature of Lessee's default is such that more than 30 days are reasonably required for its cure, then Lessee shall not be deemed to be in default if Lessee commenced such cure within said 30-day period and thereafter diligently prosecutes such cure to completion. To the extent permitted by law, said thirty (30) day notice shall constitute the sole and exclusive notice required to be given to Lessee under applicable unlawful detainer statutes.

(d) (i) The making by Lessee of any general arrangement or assignment for the benefit of creditors; (ii) Lessee becomes a "debtor" as defined in 11 U.S.C. Section 101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within 60 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the

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Premises or of Lessee's interest in this Lease, where possession is not restored to Lessee within 30 days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged within 30 days. Provided, however, in the event that any provision of this Paragraph 13.1(d) is contrary to any applicable law, such provision shall be of no force or effect

(e) The discovery by Lessor that any financial statement given to Lessor by Lessee, any assignee of Lessee, any subtenant of Lessee, any successor in interest of Lessee or any guarantor of Lessee's obligations hereunder, and any of them, was materially false.

(f) If the performance of Lessee's obligations under this Lease is guaranteed: (i) the death of a guarantor, (ii) the termination of a guarantor's liability with respect to this Lease other than in accordance with the terms of such guaranty, (iii) a guarantor's becoming insolvent or the subject of a bankruptcy filing, (iv) a guarantor's refusal to honor the guaranty, or (v) a guarantor's breach of its guaranty obligation on an anticipatory breach basis, and Lessee's failure, within sixty (60) days following written notice by or on behalf of Lessor to Lessee of any such event, to provide Lessor with written alternative assurance or security, which, when coupled with the then existing resources of Lessee, equals or exceeds the combined financial resources of Lessee and the guarantors that existed at the time of execution of this Lease.

13.2 Remedies. If Lessee fails to perform any affirmative duty or obligation of Lessee under this Lease, within ten (10) days after written notice to Lessee (or in case of an emergency, without notice), Lessor may at its option (but without obligation to do so), perform such duty or obligation on Lessee's behalf including but not limited to the obtaining of reasonably required bonds, insurance policies, or governmental licenses, permits or approvals. The costs and expenses of any such performance by Lessor shall be due and payable by Lessee to Lessor upon invoice therefor. In the event of a breach of this Lease by Lessee, as defined in Paragraph 13.1, with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such breach, Lessor may:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease and the term hereof shall terminate and Lessee shall immediately surrender possession of the Premises to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the worth at the time of the award of the unpaid rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) the worth at the time

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of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided; and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by the Lessee's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, including but not limited to the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorneys' fees, and that portion of the leasing commission paid by Lessor applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provisions (i) and (ii) of the prior sentence shall be calculated based on an interest rate equal to the highest rate permitted by applicable law. The worth at the time of award of the amount referred to in provision (iii) of the prior sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus one percent. Efforts by Lessor to mitigate damages caused by Lessee's breach of this Lease shall not waive Lessor's right to recover damages under this Paragraph. If termination of this Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding the unpaid rent and damages as are recoverable therein, or Lessor may reserve therein the right to recover all or any part thereof in a separate suit for such rent and/or damages. If a notice and grace period required under Paragraphs 13.1(b), (c) or (d) was not previously given, a notice to pay rent or quit, or to perform or quit, as the case may be, given to Lessee under any statute authorizing the forfeiture of leases for unlawful detainer shall also constitute the applicable notice for grace period purposes required by subparagraphs 13.1(b), (c) or (d). In such case, the applicable grace period under Paragraphs 13.1(b), (c) or (d) and under the unlawful detainer statute shall run concurrently after the one such statutory notice, and the failure of

Lessee to cure the default within the greater of the two such grace periods shall constitute both an unlawful detainer and breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession in effect (in California under California Civil Code Section 1951.4) after Lessee's breach and abandonment and recover the rent as it becomes due, provided Lessee has the right to sublet or assign, subject only to reasonable limitations. See Paragraphs 12 and 36 for the limitations on assignment and subletting which limitations Lessee and Lessor agree are reasonable. Acts of maintenance or preservation, efforts to relet the Premises, or the appointment of a receiver to protect the Lessor's interest under the Lease, shall not constitute a termination of the Lessee's right to possession.

(c) Pursue any other remedy now or hereafter available to Lessor under the laws or judicial decisions of the State of California. Unpaid installments of rent and other unpaid monetary obligations of Lessee under the terms of this Lease shall bear interest from the date due at the maximum rate allowed by law.

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(d) The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

13.3 Default by Lessor. Lessor shall not be in default unless Lessor fails to perform obligations required of Lessor within a reasonable time, but in no event later than thirty (30) days after written notice by Lessee to Lessor and to the holder of any first mortgage or deed of trust encumbering the Premises whose name and address shall have theretofore been furnished to Lessee in writing, specifying wherein Lessor has failed to perform such obligation; provided, however, that if the nature of Lessor's obligation is such that more than thirty (30) days are required for performance then Lessor shall not be in default if Lessor commences performance within such 30-day period and thereafter diligently prosecutes the same to completion. Any damages or judgments arising out of Lessor's default of its obligations under this Lease shall be satisfied only out of Lessor's interest and estate in the Premises, and Lessor shall have no personal liability beyond such interest and estate with respect to such damages or judgments.

13.4 Late Charges. Lessee hereby acknowledges that late payment by Lessee to Lessor of rent and other sums due hereunder will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed on Lessor by the terms of any mortgage or trust deed encumbering the Premises. Accordingly, if any installment of rent or any other sum due from Lessee shall not be received by Lessor or Lessor's designee within ten (10) days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall pay to Lessor a late charge equal to 6% of such overdue amount. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of late payment by Lessee. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's default with respect to such overdue amount, not prevent Lessor from exercising any of the other rights and remedies granted hereunder. In the event that a late charge is payable hereunder; whether or not collected, for three (3) consecutive installments of rent then rent shall automatically become due and payable quarterly in advance, rather than monthly, notwithstanding Paragraph 4 or any other provision of this Lease to the contrary.

13.5 Impounds. In the event that a late charge is payable hereunder, whether or not collected, for three (3) installments of rent or any other monetary obligation of Lessee under the terms of this Lease, Lessee shall pay to Lessor, if Lessor shall so request, in addition to any other payments required under this Lease, a monthly

advance installment, payable at the same time as the monthly rent as estimated by Lessor, for real property tax and insurance expenses on the Premises which are payable by Lessee under the terms of this Lease. Such fund shall be established to insure payment when due, before delinquency, of any or all such real Property taxes and insurance premiums. If the amounts paid to Lessor by Lessee under the provisions of this paragraph are insufficient to discharge the obligations of Lessee to pay such real property taxes and insurance premiums as the same become due, Lessee shall pay to Lessor, upon Lessor's demand, such additional sums necessary to pay such obligations. All moneys paid to Lessor under this paragraph may be intermingled with other moneys of Lessor and shall not bear interest. In the event of a default in the obligations of Lessee to perform under this Lease, then any balance remaining from funds paid to Lessor under the provisions of this paragraph may, at the option of Lessor, be applied to the payment of any monetary default of Lessee in lieu of being applied to the payment of real property tax and insurance premiums.

14. Condemnation. If the Premises or any portion thereof are taken under the power of eminent domain, or sold under the threat of the exercise of said power (all of which are herein called "condemnation"), this Lease shall terminate as to the part so taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than 10% of the floor area of the building on the Premises, or more than 25% of the land area of the Premises which is not occupied by any building, is taken by condemnation, Lessee may, at Lessee's option, to be exercised in writing only within ten (10) days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within ten (10) days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the rent shall be reduced in the proportion that the floor area of the building taken bears to the total floor area of the building situated on the Premises. No reduction of rent shall occur if the only area taken is that which does not have a building located thereon. Any award for the taking of all or any part of the Premises under the power of eminent domain or any payment made under threat of the exercise of such power shall be the property of Lessor, whether such award shall be made as compensation for diminution in value of the leasehold or for the taking of the fee, or as severance damages; provided, however, that Lessee shall be entitled to any award for loss of or damage to Lessee's trade fixtures and removable personal property. In the event that this Lease is not terminated by reason of such condemnation, Lessor shall to the extent of net severance damages received by Lessor in connection with such condemnation, over and above the legal and other expenses incurred by Lessor in the condemnation matter, repair any damage to the Premises caused by such condemnation except to the extent that Lessee has been reimbursed therefor by the condemning authority. Lessee shall pay any amount in excess of such net severance damages required to complete such repair.

15. Broker's Commissions. Lessee and Lessor each represent and warrant to the other that neither has had any dealings with any person, firm, broker or finder (other than those persons, if any, whose names are set forth in this Paragraph 15) in connection with the negotiation of this Lease and/or the consummation of the transaction contemplated hereby, and no other broker or other person, firm or entity is entitled to any commission or finder's fee in connection with said transaction and Lessee and Lessor do each hereby indemnify and hold the other harmless from and against any costs, expenses, attorneys' fees or liability for compensation, commission or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying party. Named brokers:

Lessor's Broker: None

Lessee's Broker: CB Commercial Real Estate Group

The commission payable to Lessee's Broker with respect to this Lease shall be pursuant to the terms of the separate commission agreement (the "Separate Agreement") in effect between Lessor and Lessee's Broker. Nothing in this Lease shall impose any obligation on Lessor to pay a commission or fee (a) to any party other than Lessee's Broker or (b) to any party with respect to (i) the

exercise by Lessee of any option or right of first refusal pursuant to this Lease (except as provided in the Separate Agreement), or (ii) any extension or renewal of this Lease.

16. Estoppel Certificate.

(a) Lessee shall at any time upon not less than ten (10) days' prior written notice from Lessor execute, acknowledge and deliver to Lessor a statement in writing (i) certifying that this Lease is unmodified and in full force and effect (or, if modified, stating the nature of such modification and certifying that this Lease, as so modified, is in full force and effect) and the date to which the rent and other charges are paid in advance, if any, and (ii) acknowledging that there are not, to Lessee's knowledge, any uncured defaults on the part of Lessor hereunder, or specifying such defaults if any are claimed. Any such statement may be conclusively relied upon by any prospective purchaser or encumbrancer of the Premises.

(b) At Lessor's option, Lessee's failure to deliver such statement within such time shall be a material breach of this Lease or shall be conclusive upon Lessee (i) that this Lease is in full force and effect, without modification except as may be represented by Lessor, (ii) that there are no uncured defaults in Lessor's performance, and (iii) that not more than one month's rent has been paid in advance or such failure may be considered by Lessor as a default by Lessee under this Lease.

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(c) If Lessor desires to finance, refinance, or sell the Premises, or any part thereof Lessee hereby agrees to deliver to any lender or purchaser designated by Lessor such financial statements of Lessee as may be reasonably required by such lender or purchaser. Such statements shall include the past three years' financial statements of Lessee. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. Lessor's Liability. The term "Lessor" as used herein shall mean only the owner or owners at the time in question of the fee title or a lessee's interest in a ground lease of the Premises, and in the event of any transfer of such title or interest, Lessor herein named (and in case of any subsequent transfers then the grantor) shall be relieved from and after the date of such transfer of all liability as respects Lessor's obligations thereafter to be performed, provided that any funds in the hands of Lessor or the then grantor at the time of such transfer, in which Lessee has an interest, shall be delivered to the grantee. The obligations contained in this Lease to be performed by Lessor shall, subject as aforesaid, be binding on Lessor's successors and assigns, only during their respective periods of ownership.

18. Severability. The invalidity of any provision of this Lease as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

19. Interest on Past-due Obligations. Except as expressly herein provided, any amount due to Lessor not paid when due shall bear interest at the maximum rate then allowable by law from the date due. Payment of such interest shall not excuse or cure any default by Lessee under this Lease, provided, however, that interest shall not be payable on late charges incurred by Lessee nor on any amounts upon which late charges are paid by Lessee.

20. Time of Essence. Time is of the essence.

21. Additional Rent. Any monetary obligations of Lessee to Lessor under the terms of this Lease shall be deemed to be rent.

22. Incorporation of Prior Agreements: Amendments. This Lease contains all agreements of the parties with respect to any matter mentioned herein. No prior agreement or understanding pertaining to any such matter shall be effective. This Lease may be modified in writing only, signed by the parties in interest at the time of the modification. Except as otherwise stated in this Lease, Lessee hereby acknowledges that neither the real estate broker listed in Paragraph 15 hereof nor any cooperating broker on this transaction nor the Lessor or any employees or agents of any of said persons has made any oral or written



warranties or representations to

Lessee relative to the condition or use by Lessee of said Premises and Lessee acknowledges that Lessee assumes all responsibility regarding the Occupational Safety Health Act, the legal use and adaptability of the Premises and the compliance thereof with all applicable laws and regulations in effect during the term of this Lease except as otherwise specifically stated in this Lease.

23. Notices. Any notice given pursuant to this Lease shall be in writing shall be personally delivered, delivered by Federal Express or comparable overnight courier, providing written evidence of delivery, or delivered by U.S. registered or certified mail, return receipt requested, postage prepaid and sent to Lessor and Lessee at the following addresses:

LESSOR:

Prudential Real Estate Investors  
2029 Century Park East  
Suite 2050  
Los Angeles, California 90067  
Attn: Regional Counsel

With a copy by the same method to:

The Prudential Real Estate Investors  
c/o Cushman & Wakefield of California, Inc.  
555 South Flower Street, Suite 4200  
Los Angeles, CA 90017-2413  
Attn: Mark Harryman

LESSEE:

SKECHERS USA, Inc.  
-----  
228 Manhattan Beach Blvd., #200  
-----  
Manhattan Beach, CA, 90266  
-----  
Ann: David Weinberg  
-----

With a copy by the same method to:

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or such other address as either party may from time to time designate as its notice address by notifying the other party thereof. Notice so sent shall be deemed given (a) when personally delivered, or (b) on the first business day following deposit with Federal Express or a comparable overnight courier service providing written evidence of delivery, or (c) five business days following deposit in the United States mail, if notice is sent by registered or certified mail, return receipt requested, Postage prepaid. A copy of all notices required or permitted to be given to Lessor hereunder shall be concurrently transmitted to such party or parties at such addresses as Lessor may from time to time hereafter designate by notice to Lessee.

24. Waivers. No waiver by Lessor of any provision hereof shall be deemed a waiver of any other provision hereof or of any subsequent breach by Lessee of the same or any other provision. Lessor's consent to, or approval of any act shall not be deemed to render unnecessary the obtaining of Lessor's consent to or approval of any subsequent act by Lessee. The acceptance of rent hereunder by

Lessor shall not be a waiver of any preceding breach by Lessee of any provision hereof other than the failure of Lessee to pay the particular rent so accepted, regardless of Lessor's knowledge of such preceding breach at the time of acceptance of such rent.

25. No Recording. Lessee shall not record this Lease.

26. Holding Over. If Lessee, with Lessor's consent, remains in possession of the Premises or any part thereof after the expiration of the term hereof such occupancy shall be a tenancy from month to month upon all the provisions of this Lease pertaining to the obligations of Lessee, except that the monthly rent shall be 150% of the rent payable in the last month of the Lease term, but all options and rights of first refusal, if any, granted under the terms of this Lease shall be deemed terminated and be of no further effect during said month to month tenancy.

27. Cumulative Remedies. No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at law or in equity.

28. Covenants and Conditions. Each provision of this Lease performable by Lessee shall be deemed both a covenant and a condition.

29. Binding Effect; Choice of Law. Subject to any provisions hereof restricting assignment or subletting by Lessee and subject to the provisions of Paragraph 17, this Lease shall bind the parties, their personal representatives, successors and assigns. This Lease shall be governed by the laws of the State wherein the Premises are located.

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30. Subordination; Attornment; Non-Disturbance.

30.1 Subordination. This Lease and any Option granted hereby shall be subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively, "Security Device"), now or hereafter placed upon the Premises, to any and all advances made on the security thereof and to all renewals, modifications, and extensions thereof. Lessee agrees that the holders of any such Security Devices (in this Lease together referred to as "Lessor's Lender") shall have no liability or obligation to perform any of the obligations of Lessor under this Lease. Any Lender may elect to have this Lease and/or any Option granted hereby superior to the lien of its Security Device by giving written notice thereof to Lessee, whereupon this Lease and such Options shall be deemed prior to such Security Device, notwithstanding the relative dates of the documentation or recordation thereof. Lessor warrants that there are no Security Devices encumbering the Premises on the date of this Lease.

30.2 Attornment. Subject to the non-disturbance provisions of Paragraph 30.3, Lessee agrees to attorn to a Lender or an other party who acquires ownership of the Premises by reason of a foreclosure of a Security Device, and that in the event of such foreclosure, such new owner shall not; (i) be liable for any act or omission of any prior lessor or with respect to events occurring prior to acquisition of ownership (provided that this clause (i) shall not relieve the new owner from its ongoing maintenance obligations under this Lease); (ii) be subject to any offsets or defenses which Lessee might have against any prior lessor, or (iii) be bound by prepayment of more than one (1) month's rent.

30.3 Non-Disturbance. With respect to Security Devices entered into by Lessor after the execution of this Lease, Lessee's subordination of this Lease shall be subject to receiving a commercially reasonable non-disturbance agreement (a "Non-Disturbance Agreement") from the Lender which Non-Disturbance Agreement provides that Lessee's possession of the Premises, and this Lease, including any options to extend the term hereof, will not be disturbed so long as Lessee is not in breach hereof and attorns to the record owner of the Premises.

30.4 Self-Executing. The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents; provided, however, that upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of the Premises, Lessee and Lessor shall execute

such further writings as may be reasonably required to separately document any subordination, attornment and/or Non-Disturbance Agreement provided for herein.

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31. Attorney's Fees.

(a) If either party brings an action or proceeding to enforce the terms hereof or declare rights hereunder, the prevailing party in any such proceeding, action, or appeal thereon, shall be entitled to his reasonable attorney's fees and such fees as may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term "prevailing party" shall include, without limitation, a party who obtains legal counsel or brings an action against the other by reason of the other's breach or default or who defends such action, and substantially obtains or defeats the relief sought, whether by compromise, settlement, judgment or of the claim or defense by the other party.

(b) The attorney's fee award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorney's fees reasonably incurred in good faith.

(c) Lessor shall be entitled to attorney's fees, costs and expenses incurred in the preparation and service of notices of default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such default. Lessor and Lessee agree that \$350.00 is a reasonable sum per occurrence for legal services and costs per preparation and service of a notice of default and that Lessor may include \$350.00 as additional rent due in each such notice of default as an amount that must be paid to cure said default.

32. Lessor's Access. Lessor and Lessor's agents shall have the right to enter the Premises at reasonable times for the purpose of inspecting the same, showing the same to prospective purchasers, lenders, or lessees, and making such alterations, repairs, improvements or additions to the Premises or to the building of which they are a part as Lessor may deem necessary or desirable. Lessor may at any time place on or about the Premises any ordinary "For Sale" signs and Lessor may at any time during the last 120 days of the term hereof place on or about the Premises any ordinary "For Lease" signs, all without rebate of rent or liability to Lessee.

33. Auctions. Lessee shall not conduct, nor permit to be conducted, either voluntarily or involuntarily, any auction upon the Premises without first having obtained Lessor's prior written consent. Notwithstanding anything to the contrary in this Lease, Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to grant such consent.

34. Signs. Lessee shall not place any sign upon the Premises without Lessor's prior written consent.

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35. Merger. The voluntary or other surrender of this Lease by Lessee, or a mutual cancellation thereof, or a termination by Lessor, shall not work a merger, and shall, at the option of Lessor, terminate all or any existing subtenancies or may, at the option of Lessor, operate as an assignment to Lessor of any or all of such subtenancies.

36. Consents. Except for Paragraphs 33, 34 and 47 hereof, wherever in this Lease the consent of one party is required to an act of the other party, such consent shall not be unreasonably withheld.

37. Guarantor. In the event that there is a guarantor of this Lease, said guarantor shall have the same obligations as Lessee under this Lease.

38. Quiet Possession. Upon Lessee paying the rent for the Premises and observing and performing all of the covenants, conditions and provisions on Lessee's part to be observed and performed hereunder, Lessee shall have quiet possession of the Premises for the entire term hereof subject to all of the provisions of this Lease, and all easements, covenants, conditions and restrictions of record. The

individuals executing this Lease on behalf of Lessor represent and warrant to Lessee that they are fully authorized and legally capable of executing this Lease on behalf of Lessor and that such execution is binding upon all parties holding an ownership interest in the Premises.

### 39. Options.

39.1 Definition. As used in this paragraph the word "Options" has the following meaning: (a) the right or option to extend the term of this Lease or to renew this Lease or to extend or renew any lease that Lessee has on other property of Lessor; (b) the option or right of first refusal, to lease the Premises or the right of first offer to lease the Premises or the right of first refusal to lease other property of Lessor or the right of first offer to lease other property of Lessor, (c) the right or option to purchase the Premises, or the right of first refusal to purchase the Premises, or the right of first offer to purchase the Premises or the right or option to purchase other property of Lessor, or the right of first refusal to purchase other property of Lessor or the right of first offer to purchase other property of Lessor.

39.2 Options Personal; Multiple Options. Each Option granted to Lessee in this Lease is personal to Lessee and may not be exercised or be assigned, voluntarily or involuntarily; by or to any person or entity other than Lessee, provided, however, the Option may be exercised by or assigned to any Lessee Affiliate as defined in Paragraph 12.4 of this Lease. The Options herein granted to Lessee are not assignable separate and apart from this Lease. In the event that Lessee has any multiple options to extend or renew this Lease a later option cannot be exercised unless the prior option to extend or renew this Lease has been so exercised.

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39.3 First Option. Lessor hereby grants to Lessee the option to extend the term of this Lease for a five (5) year period commencing on the date the prior term expires (the "First Option Period") upon each and all of the following terms and conditions:

(a) Lessee gives to Lessor, and Lessor actually receives, on a date which is prior to the date that the First Option Period would commence (if exercised) by at least six (6) and not more than nine (9) months, a written notice of exercise of the option to extend this Lease for said additional term, time being of the essence. If said notification of the exercise of said option is not so given and received, this option shall automatically expire;

(b) The provisions of Paragraph 39, including the provision relating to default of Lessee set forth in Paragraph 39.7, of this Lease are conditions of this option;

(c) All of the terms and conditions of this Lease except where specifically modified by this option shall apply, except that Lessee shall have no further option to extend the term of this Lease other than for the option provided for in Paragraph 39.4;

(d) Any prior Lessee that has not been expressly released from liability under this Lease, and any guarantor of the Lessee's performance hereunder, expressly reaffirms in writing the extension of their liability for the term of the option; and

(e) The monthly Base Rent for each month of the First Option Period shall be the C.P.I. Adjusted Option Rent (as defined below).

39.4 Second Option. Lessor hereby grants to Lessee the option to extend the term of this Lease for a five (5) year period commencing on the date the First Option Period expires (the "Second Option Period") upon each and all of the following terms and conditions:

(a) Lessee gives to Lessor, and Lessor actually receives, on a date which is prior to the date that the Second Option Period would commence (if exercised) by at least six (6) and not more than nine (9) months, a written notice of exercise of the option to extend this Lease for said additional term, time being of the essence. If said notification of the exercise of said option is not so given and received, this option shall automatically expire;

(b) The provisions of Paragraph 39, including the provision relating to default of Lessee set forth in Paragraph 39.7 of this Lease are conditions of this option;

(c) All of the terms and conditions of this Lease except where specifically modified by this option shall apply, except that Lessee shall have no further option to extend the term of this Lease;

(d) Any prior Lessee that has not been expressly released from liability under this Lease, and any guarantor of the Lessee's performance hereunder, expressly reaffirms in writing the extension of their liability for the term of the option; and

(e) The monthly Base Rent for each month of the option periods shall be the Fair Market Rent of the Premises as of the commencement of the Second Option Period, but in no event less than the monthly Base Rent scheduled to be paid during the month prior to the commencement of the Second Option Period.

#### 39.5 Fair Market Rent.

(a) The term "Fair Market Rent" as used in this Lease is defined to mean the rent, including all escalations, at which tenants are leasing non-sublease, non-encumbered, non-equity space comparable in size and quality to the Premises for the Option Period as to which Fair Market Rent is being determined in the Inland Empire West area, giving appropriate consideration to the annual rental rates per square foot and the standard of measurement by which the square footage is measured. In determining Fair Market Rent it shall be assumed that:

(i) The Premises are in excellent condition and repair and there shall be no deduction for depreciation, obsolescence or deferred maintenance (but less reasonable wear and tear as long as well maintained by Lessee).

(ii) The Premises would be leased for the period of the option being exercised by a tenant with the credit standing of Lessee, as the same exists at that time.

(iii) The Premises would be leased on the same terms of this Lease insofar as the obligations for repair, maintenance, insurance and real estate taxes existed as of the expiration of the original term of this Lease.

(iv) No deduction shall be given nor consideration given to allowances for real estate brokerage commissions or free rent.

(v) The Premises will be used for its highest and best use.

(b) Determination By Lessor. Lessor shall initially determine the Fair Market Rent in each instance, and shall give Lessee notice (the "Market Rent Notice") of such determination and the basis on which such determination was made on or before the 60th day prior to the date on which such determination is to take effect, or as soon thereafter as is reasonably practicable.

(c) Disputes re Fair Market Rent. In the event that Lessee notifies Lessor in writing, on or before the 20th business day following any Market Rent Notice, that Lessee disagrees with the applicable determination, Lessor and Lessee shall negotiate in good faith to resolve such dispute within 10 business days thereafter. (The 30th business day after any Market Rent Notice is referred to herein as the "Outside Agreement Date.") If not resolved by the Outside Agreement Date each party shall submit to the other its determination of Fair Market Rent and the dispute shall be submitted to arbitration in accordance

with the following paragraph titled "Arbitration Procedures." Until any such dispute is resolved, any applicable payments due under this Lease shall correspond to Lessor's determination and, if Lessee's determination becomes the final determination, Lessor shall refund any overpayments to Lessee, within 5 business days following the final resolution of the dispute.

(d) Arbitration Procedures.

(i) Lessor and Lessee shall each appoint one arbitrator who shall by profession be a real estate broker who shall have been active over the 5-year period ending on the date of such appointment in the leasing of properties similar to the Premises in the surrounding area of Los Angeles County. The determination of the arbitrators shall be limited solely to the issue of whether Lessor's or Lessee's submitted Fair Market Rent for the Premises is the closest to the actual Fair Market Rent for the Premises as determined by the arbitrators, taking into account the requirements of this subparagraph regarding the same. Each such arbitrator shall be appointed within 15 days after the Outside Agreement Date. Lessor and Lessee may not consult with either such arbitrator prior to resolution.

(ii) The two arbitrators so appointed shall within 15 days of the date of the appointment of the last appointed arbitrator, meet and attempt to reach a decision as to whether the parties shall use Lessor's or Lessee's submitted Fair Market Rent, and shall notify Lessor and Lessee of their decision, if any.

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(iii) If the two arbitrators are unable to reach a decision, the two arbitrators shall, within 30 days of the date of the appointment of the last appointed arbitrator, agree upon and appoint a 3rd arbitrator who shall be a broker who shall be qualified under the same criteria set forth hereinabove for qualification of the initial 2 arbitrators.

(iv) The 3 arbitrators shall, within 30 days of the appointment of the 3rd arbitrator, reach a decision as to whether the parties shall use Lessor's or Lessee's submitted Fair Market Rent, and shall notify Lessor and Lessee thereof.

(v) The decision of the majority of the 3 arbitrators shall be binding upon Lessor and Lessee.

(vi) If either Lessor or Lessee fails to appoint an arbitrator within 15 days after the Outside Agreement Date, the arbitrator appointed by one of them shall reach a decision, notify Lessor and Lessee thereof and such arbitrator's decision shall be binding upon Lessor and Lessee.

(vii) If the 2 arbitrators fail to agree upon and to appoint a 3rd arbitrator, then the appointment of the 3rd arbitrator shall be dismissed, and the matter to be decided shall be forthwith submitted to arbitration under the provisions of the American Arbitration Association, but subject to the instructions set forth in this Lease.

(viii) The cost of arbitration shall be paid by Lessor and Lessee equally.

39.6 C.P.I. Adjusted Option Rent. With respect to any Option Period the "C.P.I. Adjusted Option Rent" shall mean a Base Rent calculated as follows:

(a) As used herein, the term "C.P.I." shall mean the Consumer Price Index of the Bureau of Labor Statistics of the U.S. Department of Labor for Urban Wage Earners and Clerical Workers, Los Angeles-Anaheim-Riverside, California (1982-84=100). With respect to the applicable option period the Base Rent payable as set forth in Paragraph 4 of the Lease shall be multiplied by a fraction the numerator of which shall be the C.P.I. of the calendar month during which the option period commences, and the denominator of which shall be the C.P.I. for the calendar month in which the original Lease term commenced. The

sum so calculated shall constitute the "C.P.I. Adjusted Option Rent" hereunder, subject to Subparagraph 39.6(d), below.

(b) Pending receipt of the required C.P.I. and determination of the actual adjustment, Lessee shall pay an estimated adjusted Base Rent equal to an

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estimated C.P.I. Adjusted Option Rent, as reasonably determined by Lessor by reference to the then available C.P.I. information. Upon notification of the actual adjustment after publication of the required C.P.I., any overpayment shall be credited against the next installment of rent due, and any underpayment shall be immediately due and payable by Lessee. Lessor's failure to request payment of an estimated or actual rent adjustment shall not constitute a waiver of the right to any adjustment provided for in the Lease or this Paragraph 39.6.

(c) In the event the compilation and/or publication of the C.P.I. shall be transferred to any other governmental department or bureau or agency or shall be discontinued, then the index most nearly the same as the C.P.I. (as selected by Lessor) shall be used to make such calculation.

(d) The adjustment(s) required by this Paragraph 39.6 shall be subject to the following additional agreements:

(i) The increase under Paragraph 39.6(b), above, shall be subject to the following minimum and maximum percentage increase per year involved in the adjustment period, on a cumulative and compounded basis:

Minimum yearly percentage increase: 2.5%

Maximum yearly percentage increase: 6%

The "adjustment period" is defined as the period commencing with the month designated in Paragraph 39.6(a), above, as the reference for determining the "denominator", and ending with the month preceding the month designated therein as the reference for determining the "numerator". Should the adjustment period include a partial year, the minimum and maximum percentages shall be prorated for that partial year by multiplying them by a fraction, the numerator of which shall be the number of full calendar months or major portion thereof contained in said partial year, and the denominator of which is twelve (12).

(ii) The new monthly Base Rent shall in no event be less than the rent scheduled to be paid immediately preceding the rent adjustment.

#### 39.7 Effect of Default on Options.

(a) Lessee shall have no right to exercise an Option, notwithstanding any provision in the grant of Option to the contrary, (i) during the time commencing from the date Lessor gives to Lessee a notice of default pursuant to Paragraphs 13.1(b)

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or 13.1(c) and continuing until the default alleged in said notice of default is cured, or (ii) during the period of time commencing on the day after a monetary obligation to Lessor is due from Lessee and unpaid (without any necessity for notice thereof to Lessee) continuing until the obligation is paid, or (iii) at any time after an event of default described in Paragraphs 13.1(a), 13.1(d), 13.1(e) or 13.1(f) (without any necessity of Lessor to give notice of such default to Lessee), or (iv) in the event that Lessor has given to Lessee three or more notices of default under Paragraph 13.1(b), where a late charge has become payable under Paragraph 13.4 for each of such defaults, or Paragraph 13.1(c), whether or not the defaults are cured, during the 12 month period prior to the time that Lessee intends to exercise the subject Option.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 39.7.

(c) All rights of Lessee under the provisions of an Option shall terminate and be of no further force or effect, notwithstanding Lessee's due and timely exercise of the Option, if, after such exercise and during the term of this Lease, (i) Lessee fails to pay to Lessor a monetary obligation of Lessee for a period of 30 days after such obligation becomes due (without any necessity of Lessor to give notice thereof to Lessee), or (ii) Lessee fails to commence to cure a default specified in Paragraph 13.1(c) within 30 days after the date that Lessor gives notice to Lessee of such default and/or Lessee fails thereafter to diligently prosecute said cure to completion, or (iii) Lessee commits a default described in Paragraphs 13.1(a), 13.1(d), 13.1(e) or 13.1(f) (without any necessity of Lessor to give notice of such default to Lessee), or (iv) Lessor gives to Lessee three or more notices of default under Paragraph 13.1(b), where a late charge becomes payable under Paragraph 13.4 for each such default, or Paragraph 13.1(c), whether or not the defaults are cured.

40. Industrial Park Building. In the event that the Premises are part of a larger building or group of buildings then Lessee agrees that it will abide by, keep and observe all reasonable rules and regulations which Lessor may make and revise from time to time for the management, safety, care, and cleanliness of the building and grounds, the parking of vehicles and the preservation of good order therein as well as for the convenience of other occupants and tenants of the building. The violations of any such rules and regulations shall be deemed a material breach of this Lease by Lessee.

41. Security Measures. Lessee hereby acknowledges that the rental payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of Lessee, its agents and invitees from acts of third parties.

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42. Easements. Lessor reserves to itself the right, from time to time, to grant such easements, rights and dedications that Lessor deems necessary or desirable, and to cause the recordation of Parcel Maps and restrictions, so long as such easements, rights, dedications, Maps and restrictions do not unreasonably interfere with the use of the Premises by Lessee. Lessee shall sign any of the aforementioned documents upon request of Lessor and failure to do so shall constitute a material breach of this Lease by Lessee without the need for further notice to Lessee.

43. Performance Under Protest. If at any time a dispute shall arise as to any amount or sum of money to be paid by one party to the other under the provisions hereof, the party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment, and there shall survive the right on the part of said party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said party to pay such sum or any part thereof, said party shall be entitled to recover such sum or so much thereof as it was not legally required to pay under the provisions of this Lease.

44. Authority. If Lessee is a corporation, trust, or general or limited partnership, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on behalf of said entity. If Lessee is a corporation, trust or partnership, Lessee shall, within thirty (30) days after execution of this Lease, deliver to Lessor evidence of such authority satisfactory to Lessor.

45. Cashiers Checks.

(a) In the event that any check given to Lessor by Lessee shall not be honored by the bank upon which it is drawn on two or more occasions, then Lessor, at its option may require all future payments to be made by Lessee under this Lease to be made by cashier's checks.



(b) Any payment made by Lessee pursuant to a written notice to pay or be deemed in default under this Lease shall be made by cashier's check.

#### 46. Amendments to Lease.

(a) At such times as a rental adjustment is made to this Lease by virtue of any provision of this Lease, the parties shall execute a written amendment to this Lease to reflect said change.

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(b) Lessee agrees to make any non-monetary modifications to this Lease that may be required by an institutional mortgagee of Lessor.

#### 47. Storage Tanks.

(a) Notwithstanding anything to the contrary in Paragraph 7.5 hereof, Lessee shall not install storage tanks of any size or shape in the Premises, above or below ground, without the consent of the Lessor which can be withheld in Lessor's sole discretion. If Lessor elects to grant its consent, Lessor shall have the right to condition its consent upon Lessee agreeing to give to Lessor such assurances that Lessor, in its sole discretion, deems necessary to protect itself against potential problems concerning the installation, use, removal and contamination of the Premises as a result of the installation and/or use of such tank, including but not limited to the installation of a concrete encasement for said tank. Lessee shall comply at its expense with all applicable permit and/or registration requirements and repair any damage caused by the installation, maintenance or removal of such tank. Upon termination of the Lease, Lessee shall, at its sole cost and expense, remove any tank from the Premises, remove and replace any contaminated soil or materials (and compact or treat the same as then required by law) and repair any damage or change to the Premises caused by said installation and/or removal. Nothing contained herein shall be construed to diminish or reduce Lessee's obligations under Paragraph 48.

(b) Lessor shall have the right to employ experts and/or consultants, at Lessee's expense, to advise Lessor with respect to the installation, operation, monitoring, maintenance and removal and restoration of any such tank.

#### 48. Lessee's Covenants Regarding Hazardous Materials.

48.1 Lessor's Prior Consent. Notwithstanding anything contained in this Lease to the contrary, Lessee has not caused or permitted, and shall not cause or permit any "Hazardous Materials" (as defined in Paragraph 48.2, below) to be brought upon, kept, stored, discharged, released or used in, under or about the Premises by Lessee, its agents, employees, contractors, subcontractors, licensees or invitees, unless (a) such Hazardous Materials are reasonably necessary to Lessee's business and will be handled, used, kept, stored and disposed of in a manner which complies with all "Hazardous Materials Laws" (as defined in Paragraph 48.2, below); (b) Lessee will comply with such other rules or requirements as Lessor may from time to time impose, including without limitation that (i) such materials are in small quantities, properly labeled and contained, (ii) such materials are handled and disposed of in accordance with the highest accepted industry standards for safety, storage, use and disposal, (iii) such materials are for use in the ordinary course of business (i.e., as with office or cleaning supplies), (c) notice of and a copy of the current material safety data sheet is

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provided to Lessor for each such Hazardous Material, and (d) Lessor shall have granted its prior written consent to the use of such Hazardous Materials.

48.2 Compliance with Hazardous Materials Laws. As used herein, the term "Hazardous Materials" means any (a) oil, petroleum, petroleum products, flammable substances, explosives, radioactive materials, hazardous wastes or substances, toxic wastes or substances or any other wastes, materials or pollutants which (i) pose a hazard to the Premises or to persons on or about the

Premises or (ii) cause the Premises to be in violation of any Hazardous Materials Laws (as hereinafter defined); (b) asbestos in any form, urea formaldehyde foam insulation, transformers or other equipment which contain dielectric fluid containing levels of polychlorinated biphenyls, or radon gas; (c) chemical, material or substance defined as or included in the definition of "hazardous substances," "hazardous wastes," "hazardous materials," "extremely hazardous waste," "restricted hazardous waste," or "toxic substances" or words of similar import under any applicable local, state or federal law or under the regulations adopted or publications promulgated pursuant thereto, including, but not limited to, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C. Section 9601, et seq.; the Resources Conservation Recovery Act, 42 U.S.C. Section 6901, et seq.; the Hazardous Materials Transportation Act, as amended, 49 U.S.C. Section 1801, et seq.; the Federal Water Pollution Control Act, as amended, 33 U.S.C. Section 1251, et seq.; Sections 25115, 25117, 25122.7, 25140, 25249.8 25281, 25316 and 25501 of the California Health and Safety Code; and Article 9 or Article II of Title 22 of the California Code of Regulations, Division 4, Chapter 20; (d) other chemical, material or substance, exposure to which is prohibited, limited or regulated by any governmental authority or may or could pose a hazard to the health and safety of the occupants of the Premises or the owners and/or occupants of property adjacent to or surrounding the Premises, or any other Person coming upon the Premises or adjacent property; and (e) other chemical, materials or substance which may or could pose a hazard to the environment. As used herein the term "Hazardous Materials Laws" means any federal, state or local laws, ordinances, regulations or policies relating to the environment, health and safety, and Hazardous Materials (including, without limitation, the use, handling, transportation, production, disposal, discharge or storage thereof) or to industrial hygiene or the environmental conditions on, under or about the Premises, including, without limitation, soil, groundwater and indoor and ambient air conditions. Lessee shall at all times and in all respects comply with all Hazardous Materials Laws.

48.3 Hazardous Materials Removal. Upon expiration or earlier termination of this Lease, Lessee shall, at Lessee's sole cost and expense, cause all Hazardous Materials brought on the Premises with Lessor's consent to be removed from the Premises in compliance with all applicable Hazardous Materials Laws. If Lessee or its employees, agents, or contractors violates the provisions of the foregoing two paragraphs, or if Lessee's acts, negligence, or business operations contaminate or

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expand the scope of contamination of, the Premises from such Hazardous Materials, then Lessee shall promptly; at Lessee's expense, take all investigatory and/or remedial action (collectively, the "Remediation") that is necessary in order to clean up, remove and dispose of such Hazardous Materials causing the violation on the Premises or the underlying groundwater or the properties adjacent to the Premises to the extent such contamination was caused by Lessee, in compliance with all applicable Hazardous Materials Laws. Lessee shall further repair any damage to the Premises caused by the Hazardous Materials contamination. Lessee shall provide prior written notice to Lessor of such Remediation, and Lessee shall commence such Remediation no later than thirty (30) days after such notice to Lessor and diligently and continuously complete such Remediation. Such written notice shall also include Lessee's method, time and procedure for such Remediation and Lessor shall have the right to require reasonable changes in such method, time or procedure of the Remediation. Lessee shall not take any Remediation in response to the presence of any Hazardous Materials in or about the Premises or enter into any settlement agreement, consent decree or other compromise in respect to any claims relating to any Hazardous Materials in any way connected with the Premises, without first notifying Lessor of Lessee's intention to do so and affording Lessor ample opportunity to appear, intervene or otherwise appropriately assert and protect Lessor's interests with respect thereto.

48.4 Notices. Lessee shall immediately notify Lessor in writing of: (a) any enforcement, cleanup, removal or other governmental or regulatory action threatened, instituted, or completed pursuant to any Hazardous Materials Laws with respect to the Premises; (b) any claim, demand, or complaint made or threatened by any person against Lessee or the Premises relating to damage, contribution, cost recovery compensation, loss or injury resulting from any Hazardous Materials; and (c) any reports made to any governmental authority

arising out of any Hazardous Materials on or removed from the Premises. Lessor shall have the right (but not the obligation) to join and participate, as a party, in any legal proceedings or actions affecting the Premises initiated in connection with any Hazardous Materials Laws.

48.5 Indemnification of Lessor. Lessee shall indemnify, protect, defend and forever hold Lessor harmless from any and all damages, losses, expenses, liabilities, obligations and costs arising out of any failure of Lessee to observe the foregoing covenants in Paragraphs 47 and 48. The provisions of Paragraphs 47 and 48 shall survive the expiration or earlier termination of the lease.

#### 49. The Causeway Improvements.

A prior tenant constructed a causeway (the "Causeway") between the Premises and the building leased by lessee from Lessor under the Other Lease (as defined in Paragraph 50). Lessee shall be solely responsible for obtaining and maintaining all permits, approvals, variances, consents and other authorizations required by applicable

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law in connection with the Causeway. Lessor shall not be obligated to enter into any covenants or other agreements affecting Lessor's interest in the Premises in connection with the Causeway, including without limitation any covenant requiring the Premises and the Other Lease Premises (as defined below) to be held as one parcel. Lessor shall have no obligation to provide a bond or other security for the maintenance or removal of the Causeway. In the event a bond or other security is provided by Lessee in connection with the Causeway, Lessor shall be an additional beneficiary of that bond or other security.

Upon or after the expiration or earlier termination of either or both of this Lease and the Other Lease (as defined below), Lessor may require Lessee to demolish and remove the Causeway and to restore the Premises to its condition prior to the construction of the Causeway at Lessee's sole cost and expense. Lessee agrees to obtain a demolition permit and commence that demolition, removal and restoration no later than 30 days after Lessor's request and to complete that demolition removal and restoration no later than 30 days after receipt of the demolition permit. In the event that Lessee fails to (a) obtain a demolition permit and commence that demolition within 30 days after Lessor's request, or (b) complete that demolition, removal and restoration within such 30-day period after receipt of that demolition permit, Lessor shall have the option to perform such work itself at Lessee's cost. In addition, Lessee's failure to demolish and remove the Causeway and restore the Premises shall be a material default by Lessee under this Lease and, if so elected by the Lessor under the Other Lease, a material default under the Other Lease. Lessee hereby indemnifies Lessor and agrees to defend, protect and hold Lessor harmless from and against any claims, demands, liens, causes of action, loss and liability arising out of, or in any way related to, the planning, construction, operation, maintenance, repair, demolition and removal of the Causeway, and restoration of the Premises. This indemnification shall survive the expiration or earlier termination of the Lease, and any assignment of the Lease.

The insurance policies required by this Lease and the Other Lease shall be modified or endorsed to cover, to the extent customary, all risks arising out of the operation, maintenance, repair, demolition and removal of the Causeway. Lessee shall pay on demand all additional costs of insurance required by Lessor to the extent the same are customarily carried by prudent Lessors in connection with the maintenance and use of improvements such as the Causeway.

Neither this Lease nor any existence or use of the Causeway shall give rise to easements, licenses, servitudes or other rights for the benefit of the Premises over the Other Lease Premises or for the benefit of the Other Lease Premises over the Premises. Any rights or privileges to use the Causeway for ingress and egress from and to the Premises and the Other Premises shall not burden or run with the land, and shall

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terminate automatically upon the expiration or earlier termination of either this Lease or the Other Lease.

Without limiting any other restriction in this Lease on assignment or subletting, Lessor may condition its consent to any assignment or subletting of the Premises that would result in less than 10,000 square feet in each of the Premises and the Other Premises being occupied by at least one common occupant upon Lessee's demolition and removal of the Causeway and restoration of the Premises to the condition that existed prior to the construction of the Causeway.

50. Relationship to Other Lease. Concurrently herewith, Lessor and Lessee are entering into another Lease (the "Other Lease") of even date herewith of the property commonly known as 1771 Vintage Avenue, Ontario, California (the "Other Lease Premises"). Neither this Lease nor the Other Lease shall be effective unless and until both are fully executed and delivered. Lessor and Lessee acknowledge that the Other Lease and this Lease are not cross-defaulted or otherwise dependent, except as expressly provided in Article 49 with respect to the Causeway.

51. L.A. Gear. The Premises is currently leased to LA. Gear, Inc. ("Gear") and the effectiveness of this Lease is subject to Lessor obtaining from Gear an agreement (the "Termination Agreement") satisfactory to Lessor in its sole discretion with respect to the termination of Gear's tenancy in the Premises. In addition, in the event the Termination Agreement ceases to be effective and rights of Gear with respect to the

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Premises are Reinstated, then this Lease shall terminate effective as of the date the Termination Agreement ceases to be effective.

52. Existing Sublease. As a condition precedent to the effectiveness of this Lease, Lessee shall have caused the termination of all existing subleases in the Premises, without any cost, expense or liability to Lessor and provided Lessor with reasonable evidence of that termination.

"LESSOR":

THE PRUDENTIAL INSURANCE COMPANY  
OF AMERICA, a New Jersey corporation?

By CUSHMAN & WAKEFIELD OF  
CALIFORNIA, INC.,  
its Managing Agent

By /s/ MARK F. HARRYMAN  
-----  
MARK F. HARRYMAN -- PORTFOLIO MGR  
-----  
[Printed Name and Title]

By /s/ WILLIAM DURSLAG  
-----  
WILLIAM DURSLAG -- DIRECTOR  
-----  
[Printed Name and Title]

"LESSEE":

SKECHERS U.S.A., INC.

By /s/ DAVID WEINBERG

-----  
David Weinberg, C.F.O.

-----  
[Printed Name and Title]

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EXHIBIT A

[Floorplan depicting leased premises located at 1661 South Vintage Avenue, Ontario, California. The floorplan includes dotted lines to depict two existing rail easements running along the north and east sides of the building.]

1661 S. VINTAGE AVE.  
LEASE

Premises are Reinstated, then this Lease shall terminate effective as of the date the Termination Agreement ceases to be effective.

52. Existing Sublease. As a condition precedent to the effectiveness of this Lease, Lessee shall have caused the termination of all existing subleases in the Premises, without any cost, expense or liability to Lessor and provided Lessor with reasonable evidence of that termination.

"LESSOR"

THE PRUDENTIAL INSURANCE COMPANY  
OF AMERICA, a New Jersey corporation?

By CUSHMAN & WAKEFIELD OF  
CALIFORNIA, INC.,  
its Managing Agent

By /s/ MARK F. HARRYMAN  
-----  
Mark F. Harryman-Portfolio Mgr.

By /s/ WILLIAM DURSLAG  
-----  
William Durslag-Director

"LESSEE":

SKECHERS U.S.A., INC.

BY: /s/ DAVID WEINBERG  
-----  
David Weinberg, C.F.O.



EXHIBIT 10.15

LEASE  
between  
THE PRUDENTIAL INSURANCE COMPANY OF AMERICA  
and  
SKECHERS U.S.A., INC.

(Single Tenant Net)

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Exhibit "A"      Premises (Paragraph 2)

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LEASE

1. Parties. This Lease, dated, for reference purposes only, November 21, 1997, is made by and between THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, a New Jersey corporation (herein called "Lessor") and SKECHERS U.S.A., INC. (herein called "Lessee").

2. Premises. Lessor hereby leases to Lessee and Lessee leases from Lessor for the term, at the rental, and upon all of the conditions set forth herein, that certain real property situated in the County of San Bernardino, State of California, commonly known as 1777 South Vintage Avenue, Ontario, California consisting of a 284,559 square foot building (including a portion of the Causeway (as defined below)) and adjacent land and more particularly delineated on Exhibit "A" attached hereto and by this reference incorporated herein. Said real property including the land and all improvements therein, is herein called the "Premises."

3. Term.

3.1 Term. The term of this Lease shall be for five (5) years commencing on December 1, 1997 and ending on November 30, 2002, unless sooner terminated pursuant to any provision hereof

3.2 Delay in Possession. Notwithstanding said commencement date, if for any reason Lessor cannot deliver possession of the Premises to Lessee on said date, Lessor shall not be subject to any liability therefor, nor shall such failure affect the validity of this Lease or the obligations of Lessee hereunder or extend the term hereof, but in such case, Lessee shall not be obligated to pay rent until possession of the Premises is tendered to Lessee; provided, however, that if Lessor shall not have delivered possession of the Premises within sixty (60) days from said commencement date, Lessee may, at Lessee's option, by notice in writing to Lessor within ten (10) days thereafter, cancel this Lease, in which event the parties shall be discharged from all obligations hereunder; provided further, however, that if such written notice of Lessee is not received by Lessor within said ten (10) day period, Lessee's right to cancel this Lease hereunder shall terminate and be of no further force or effect.

3.3 Early Possession. If Lessee occupies the Premises prior to said commencement date, such occupancy shall be subject to all provisions hereof such occupancy shall not advance the termination date, and Lessee shall pay rent for such period at the initial monthly rates set forth below.

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4. Base Rent. Lessee shall pay to Lessor as rent for the Premises, monthly payments of \$81,100.00 ("Base Rent"), in advance, on the first day of each month of the term hereof. Lessee shall pay Lessor upon the execution hereof \$81,100.00 as rent for December 1997. Rent for any period during the term hereof which is for less than one month shall be a pro rata portion of the monthly installment. Rent shall be payable in lawful money of the United States to Lessor at the address stated herein or to such other persons or at such other places as Lessor may designate in writing, without any offset or deduction.

5. Security Deposit. Lessee shall deposit with Lessor upon execution hereof \$162,200.00 as security for Lessee's faithful performance of Lessee's obligations hereunder. If Lessee fails to pay rent or other charges due hereunder, or otherwise defaults with respect to any provision of this Lease, Lessor may use, apply or retain all or any portion of said deposit for the payment of any rent or other charge in default or for the payment of any other sum to which Lessor may become obligated by reason of Lessee's default, or to compensate Lessor for any loss or damage which Lessor may suffer thereby. If Lessor so uses or applies all or any portion of said deposit, Lessee shall within ten (10) days after written demand therefor deposit cash with Lessor in an amount sufficient to restore said deposit to the full amount hereinabove stated and Lessee's failure to do so shall be material breach of this Lease. If the monthly rent shall, from time to time, increase during the term of this Lease, Lessee shall thereupon deposit with Lessor additional security deposit so that the amount of security deposit held by Lessor shall at all times bear the same proportion to current Base Rent as the original security deposit bears to the original monthly rent set forth in Paragraph 4 hereof. Lessor shall not be required to keep said deposit separate from its general accounts. If Lessee performs all of Lessee's obligations hereunder, said deposit, or so much thereof as has not theretofore been applied by Lessor, shall be returned, without payment of interest or other increment for its use, to Lessee (or, at Lessor's option, to the last assignee, if any, of Lessee's interest hereunder) at the expiration of the term hereof and after Lessee has vacated the Premises. No trust relationship is created herein between Lessor and Lessee with respect to said Security Deposit.

6. Use.

6.1 Use. The Premises shall be used and occupied, subject to the other terms of this Lease, only for warehousing and distribution in any customary manner permitted by applicable law and for no other purpose.

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6.2 Compliance with Law. Lessee shall, at Lessee's expense, comply promptly with all applicable statutes, ordinances, rules, regulations, orders, covenants and restrictions of record, and requirements in effect during the term or any part of the term hereof, relating in any manner to the Premises and the occupation and use by Lessee of the Premises. Lessee shall not use nor permit the use of the Premises in any manner that will tend to create waste or a nuisance or, if there shall be more than one tenant in the building containing the Premises, shall tend to disturb such other tenants.

6.3 Condition of Premises. Lessee hereby accepts the Premises in their "as is" condition existing as of the Lease commencement date or the date that Lessee takes possession of the Premises, whichever is earlier, subject to all applicable zoning, municipal, county and state laws, ordinances and regulations governing and regulating the use of the Premises, and any covenants or restrictions or easements of record, and accepts this Lease subject thereto and to all matters disclosed thereby and by any exhibits attached hereto. Lessee acknowledges that neither Lessor nor Lessor's agent has made any representation or warranty as to the present or future suitability of the Premises for the conduct of Lessee's business.

7. Maintenance, Repairs and Alterations.

7.1 Lessee's Obligations.

(a) Except to the extent of Lessor's obligations under Paragraph 7.4, below, Lessee shall keep in good order, condition and repair the interior of the Premises and every structural or nonstructural part thereof (whether or not such portion of the Premises requiring repair, or the means of repairing the same are reasonably or readily accessible to Lessee, and whether or not the need for such repairs occurs as a result of Lessee's use, any prior use, the elements or the age of such portion of the Premises) including, without limiting the generality of the foregoing, all plumbing, heating and air conditioning (Lessee shall procure and maintain, at Lessee's expense, an air conditioning system maintenance contract) ventilating, electrical, lighting facilities and equipment within the Premises, fixtures, walls (interior and exterior), ceilings, roofs (interior), floors, windows, doors, plate glass and skylights located within the Premises, and all driveways, parking lots, fences and signs located on the Premises and sidewalks and parkways adjacent to the Premises.

(b) Lessee shall maintain the Premises as provided in Paragraph 7.1(a) and in accordance with the requirements of any covenants or restrictions as may from time to time be applicable to the Premises. Lessee, in keeping the Premises in good order, condition and repair, shall exercise and perform good maintenance practices and any damage or deterioration shall not be deemed "ordinary

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wear and tear" if the same could have been prevented by good maintenance practice. Lessee's obligations shall include restorations, replacements or renewals when necessary and when determined not to be due to ordinary wear and tear, in order to keep the Premises and all improvements thereon or a part thereof in good order, condition and state of repair. Notwithstanding anything contained in the Lease to the contrary, Lessee shall make all repairs whatsoever on the Premises necessitated by the negligence, misconduct or fault of Lessee, or its agents, licensees or agents.

7.2 Surrender. On the last day of the term hereof, or on any sooner termination, Lessee shall surrender the Premises to Lessor in the same condition as when received, ordinary wear and tear excepted, clean and free of debris. Lessee shall repair any damage to the Premises occasioned by the installation or removal of Lessee's trade fixtures, furnishings and equipment (including without limitation the following components of Lessee's material handling system:

racking, conveyors, mezzanine and related utilities (collectively, "Lessee's Systems"). Notwithstanding anything to the contrary otherwise stated in this Lease, upon termination of this Lease, (a) Lessee shall remove from the Premises Lessee's Systems, and (b) Lessee shall leave the air lines, power panels, electrical distribution systems, mechanical systems, lighting fixtures, air conditioning, plumbing, heating (including space heaters) and fencing on the Premises (other than Lessee's Systems, which shall be removed from the Premises as provided above) in good condition and operating order, and Lessee shall upon demand pay to Lessor that portion of the cost to restore such items to good condition and operating order as may be reasonably allocable to Lessee's tenancy.

7.3 Lessor's Rights. If Lessee fails to perform Lessee's obligations under this Paragraph 7, or under any other paragraph of this Lease, Lessor may at its option (but shall, not be required to) enter upon the Premises after ten (10) days' prior written notice to Lessee (except in the case of an emergency, in which case no notice shall be required), perform such obligations on Lessee's behalf and put the same in good order, condition and repair, and the cost thereof together with interest thereon at the maximum rate then allowable by law shall become due and payable as additional rental to Lessor together with Lessee's next rental installment.

#### 7.4 Lessor's Obligations.

(a) Except for the obligations of Lessor under Paragraph 9 (relating to destruction of the Premises), under Paragraph 14 (relating to condemnation of the Premises) and Paragraph 7.4(b), it is intended by the parties hereto that Lessor have no obligation, in any manner whatsoever, to repair and maintain the Premises nor the building located thereon nor the equipment therein, whether structural or non structural, all of which obligations are intended to be that of the Lessee under

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Paragraph 7.1 hereof. Lessee expressly waives the benefit of any statute now or hereinafter in effect which would otherwise afford Lessee the right to make repairs at Lessor's expense or to terminate this Lease because of Lessor's failure to keep the Premises in good order, condition and repair.

(b) Lessor shall replace the roof (exterior only) as necessary and maintain and repair the structural components of the perimeter wall of the Premises, subject to normal wear and tear, provided the need for such replacement, maintenance or repair does not arise because of the negligence, misconduct or fault of Lessee, or its agents, licensees or invitees.

#### 7.5 Alterations and Additions.

(a) Lessee shall not, without Lessor's prior written consent make any alterations, improvements, additions, or Utility Installations in, on or about the Premises, except for nonstructural alterations not exceeding \$10,000 in cumulative costs during any 12-month period (the "Threshold Amount"). In any event, whether or not in excess of the Threshold Amount, Lessee shall make no change or alteration to the exterior of the Premises nor the exterior of the building(s) on the Premises without Lessor's prior written consent. As used in Paragraph 7.5, the term "Utility Installation" shall mean carpeting, window coverings, air lines, power panels, electrical distribution systems, lighting fixtures, space heaters, air conditioning, plumbing and fencing. Lessor may require Lessee to provide Lessor, at Lessee's sole cost and expense, a lien and completion bond in an amount equal to one and one-half times the estimated cost of such improvements, to insure Lessor against any liability for mechanic's and materialmen's liens and to insure completion of the work. Lessor's consent shall not be required for reconfiguration, relocation or modification to the racking and material handling system, including electrical work related thereto; provided none of such work is structural and all of such work is in the interior of the building on the Premises.

(b) Any alterations, improvements, additions, or Utility Installations made by Lessee during the term of this Lease shall be done in a good and workmanlike manner and of good and sufficient materials, and Lessee shall, within thirty (30) days after completion of such alteration, improvements, addition or Utility Installation, provide Lessor with as-built plans and specifications for same. Notwithstanding anything contained in this

Lease to the contrary, Paragraphs 7.5(d)(1)(ii) and (iii) shall apply to non-structural alterations, improvements, additions or Utility Installations (other than racking, shelving and temporary partitions) not exceeding the Threshold Amount.

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(c) Any alterations, improvements, additions or Utility Installations in, or about the Premises that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written form, with proposed detailed plans. If Lessor shall give its consent, the consent shall be conditioned upon satisfaction of all of the requirements set forth in Paragraph 7.5(d), below.

(d) For any additions, alterations, improvements, or Utility Installations requiring Lessor's prior written consent:

(1) Lessee shall:

(i) Request Lessor's approval in writing at least thirty (30) days prior to proposed construction.

(ii) Employ a California licensed architect, contractor and structural engineer in connection with the proposed construction.

(iii) Be fully responsible for the acts of Lessee's consultants, employees, contractors, subcontractors, invitees and agents, and cause them to fully comply with any applicable terms of this Lease and documents referred to by this Lease and all applicable laws, rules and regulations.

(iv) Cause to be obtained an applicable building permit for any and all construction and modifications, and construct the additions and alterations and perform the construction work in accordance with all applicable laws, including without limitation the Americans With Disabilities Act.

(2) Lessee's architect shall:

(i) Be licensed by the State of California.

(ii) Design and specify within the parameters of the building work letter and approved building specifications or have received specific written exceptions from the Lessor.

(iii) Secure Lessor's written approval before submitting plans to the general contractor for bidding or to governmental agencies for approval.

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(iv) Secure Lessor's written approval of any changes or alternates to the plans recommended by the general contractor or required by governmental agencies.

(v) Submit a copy of the final application for permit and issued permit to Lessor.

(vi) Incorporate the building standard details supplied by Lessor onto the drawings.

(vii) Submit final plans for Lessor's written approval prior to construction.

(viii) Be available for final inspection with Lessor at job completion.

(ix) Secure Lessor's written approval of details of any changes in specifications or finishes during construction.

(x) Provide samples and specifications as required by Lessor.

(xi) Sign off on the as-built drawings as the Architect's certification that the improvements have, in fact, been built as per the Architect's design.

(3) Lessee's general contractor and/or subcontractors shall:

(i) Be licensed by the State of California.

(ii) Have substantial experience providing similar quality and quantity of improvements. Work history shall be provided to Lessor prior to being awarded contract.

(iii) Have a bonding capacity equal to or exceeding the valuation of the job. Lessor may, at its sole option, require the job to be bonded.

(iv) Maintain in full force and effect, throughout the duration of its performance under the contract with the Lessee, a Worker's Compensation insurance policy and a Commercial General Liability insurance

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policy issued by an insurer satisfactory to Lessor with liability coverage of not less than \$1,000,000.00 for personal injury and \$500,000.00 to cover property damage. The Commercial General Liability insurance policy shall include assumption of contractual liability. Certificates of insurance containing a thirty (30) day cancellation clause shall be furnished to Lessor prior to commencement of performance under the construction contract naming Lessor (The Prudential Insurance Company of America) and its managing agent as additional insureds.

(v) Provide a construction schedule to Lessor prior to commencement of work and weekly written progress reports.

(vi) Warrant the Contractor's work and that of the Contractor's subcontractors, for a minimum of one (1) year.

(vii) Provide Lessor with as-built drawings of all improvements.

(e) All approvals by Lessor, as provided for in this Paragraph 7.5, shall not be unreasonably withheld. All requests to be submitted to Lessor shall be submitted through Lessor's managing agent. If Lessor shall give its consent, the consent shall be deemed conditioned upon the compliance by Lessee in a prompt and expeditious manner of all conditions of all permits obtained pursuant to Paragraph 7.5(d), above.

(f) Lessee shall pay, when due, all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use in the Premises, which claims are or may be secured by any mechanics' or materialmen's lien against the Premises or any interest therein. Lessee shall give Lessor not less than thirty (30) days' notice prior to the commencement of any work in the Premises, and Lessor shall have the right to post notices of non-responsibility in or on the Premises as provided by law. If Lessee shall, in good faith, contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense defend itself and Lessor against the same and shall pay and satisfy any such adverse judgment that may be rendered thereon before the enforcement thereof against the Lessor or the Premises, upon the condition that if Lessor shall require, Lessee shall furnish to Lessor a surety bond satisfactory to Lessor in an amount equal to such contested lien claim or demand indemnifying Lessor against liability for the same and holding the Premises free from the effect of such lien or claim. In addition, Lessor may require Lessee to pay Lessor's attorneys fees and costs in participating in such action if Lessor shall decide it is in its best interest to do so; provided Lessor agrees that Lessee shall not be obligated to pay

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such fees pursuant to this sentence with respect to any period in which both (a) Lessee has provided the surety bond required above, and (b) Lessor has not been named in such action.

(g) Unless otherwise agreed in writing, Lessor may require that any or all alterations, improvements, additions or Utility Installations be removed by the expiration or earlier termination of this Lease, notwithstanding their installation may have been consented to by Lessor, and that the Premises be restored to their prior condition. Should Lessee make any alterations, improvements, additions or Utility Installations without the prior approval of Lessor, Lessor may require that Lessee remove any or all of the same.

(h) Unless Lessor requires their removal, as set forth in Paragraph 7.5(g), all alterations, improvements, additions and Utility Installations (whether or not such Utility Installations constitute trade fixtures of Lessee), which may be made on the Premises, shall become the property of Lessor and remain upon and be surrendered with the Premises at the expiration of the term. Notwithstanding the provisions of this Paragraph 7.5(h), Lessee's machinery and equipment, other than that which is affixed to the Premises so that it cannot be removed without material damage to the Premises, shall remain the property of Lessee and may be removed by Lessee subject to the provisions of Paragraph 7.2.

8. Insurance: Indemnity.

(a) Lessee hereby agrees to indemnify, defend and hold harmless Lessor, its successors, assigns, subsidiaries, directors, officers, agents and employees from and against any and all damage, loss, liability or expense including, but not limited to, attorney's fees and legal costs suffered by same directly or by reason of any claim, suit or judgment brought by or in favor of any person or persons for damage, loss or expense due to, but not limited to, bodily injury, including death resulting anytime therefrom, and property damage sustained by such person or persons which arises out of, is occasioned by or in any way attributable to the use or occupancy of the Premises by the Lessee, the acts or omission of the Lessee, its agents, employees or any other contractors brought onto said Premises by the Lessee, or any breach or default in the performance of any obligation on Lessee's part to be performed under the terms of this Lease, except to the extent caused by the sole gross negligence or willful misconduct of Lessor, its employees, and agents. If any action or proceeding is brought against Lessor by reason of any such claim, Lessee, upon notice from Lessor, shall defend same at Lessee's expense by counsel satisfactory to Lessor. Such loss or damage shall include, but not be limited to, any injury or damage to Lessor's personnel (including death resulting anytime therefrom) on the Premises. Lessor shall not be

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liable for any damages arising from any act or neglect of any other tenant, if any, of the building or industrial park in which the Premises are located. Lessee agrees that the obligations assumed herein shall survive the termination of this Lease.

(b) Lessee hereby agrees to maintain in full force and effect at all times during the term of this Lease, at Lessee's own expense, for the protection of Lessee, Lessor and Lessor's property manager, as their interest may appear, policies of insurance issued by a responsible carrier or carriers to Lessor which afford the following coverages:

(i) Workers' Compensation with statutory limits.

(ii) Employers' Liability insurance with the following minimum limits:

<TABLE>	
<S>	<C>
Bodily injury by disease per person	\$1,000,000
Bodily injury by accident policy limit	\$1,000,000
Bodily injury by disease policy limit	\$1,000,000

</TABLE>

(iii) Property insurance on a special causes of loss

insurance form covering any and all personal property of Lessee including but not limited to improvements, betterments, furniture, fixtures, Utility Installations, and equipment in an amount not less than their full replacement cost, with a deductible not to exceed \$10,000. This policy should contain a waiver of subrogation.

(iv) Commercial General Liability Insurance including Broad Form Property Damage and Contractual Liability with the following minimum limits:

<TABLE>	
<S>	<C>
General Aggregate	\$2,000,000
Products/Completed Operations Aggregate	\$2,000,000
Each Occurrence	\$1,000,000
Personal & Advertising Injury	\$1,000,000
Medical Payments	\$5,000 per person

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(v) Umbrella/Excess, Liability on a following form basis with the following minimum limits:

<TABLE>	
<S>	<C>
General Aggregate	\$10,000,000
Each Occurrence	\$10,000,000

The limits of said insurance in this Paragraph 8(b)(i) shall not however, limit the liability of Lessee hereunder.

(c) If Lessor is providing property insurance on the Premises, then Lessor shall, at all times during the term of this Lease, maintain the following insurance:

(i) a policy or policies of all-risk property insurance, issued by and binding upon some solvent insurance company, insuring for the full replacement cost of the building on the Premises. Lessor shall not be obligated to insure, and shall not assume any liability or risk of loss for, any of Lessee's furniture, equipment, machinery, goods, supplies, utility installations, improvements, or alterations upon the Premises. This policy shall contain an agreed amount endorsement and be written with no coinsurance. Lessor may, but shall not be obligated to, obtain earthquake and flood insurance.

(ii) Rent insurance on an all-risk basis in an amount equal to all that is called for under Paragraph 4 of this Lease (Base Rent and any additional rents payable under this Lease including tax and insurance costs) for a period of at least twelve (12) months commencing with the date of loss.

(iii) Boiler and machinery insurance in an amount satisfactory to Lessor on a comprehensive coverage form.

Lessor may elect to have reasonable deductibles in connection with the insurance specified in Paragraph 8(c), and Lessee shall be liable for such deductible amount.

(d) The Lessee shall deliver to Lessor at least thirty (30) days prior to the time such insurance is first required to be carried by Lessee, and thereafter at least thirty (30) days prior to expiration of such policy, certificates of insurance evidencing the above coverage with limits not less than those specified above. Insurance required hereunder shall be in companies holding a "General Policyholders Rating" of at least A-VIII as set forth in the most current issue of "A.M. Best's Insurance Guide". Such Certificates with the exception of Worker's Compensation, shall name Lessor, its subsidiaries, directors, agents and employees, and its property manager as additional



insureds and shall expressly provide that the interest of same herein shall not be affected by a breach by Lessee of any insurance policy provision for which such Certificates evidence coverage. Further, all Certificates shall expressly provide that no less than thirty (30) days prior written notice shall be given to Lessor in the event of material alteration to or cancellation of the coverage evidenced by such Certificates.

(e) Upon demand, Lessee shall provide Lessor, at Lessee's expense, with such increased amount of existing insurance and such other insurance coverage in such limits as Lessor may require in its sole judgement to afford Lessor adequate protection.

(f) If, on account of the failure of Lessee to comply with the foregoing provisions, Lessor is adjudged a co-insurer by the insurance carrier, then any loss or damage Lessor shall sustain by reason thereof shall be borne by Lessee and shall be immediately paid by Lessee upon receipt of bill thereof and evidence of such loss.

(g) Lessor makes no representation that the limits of liability specified to be carried by Lessee under the term of this Lease are adequate to protect Lessee against Lessee's undertaking under this Paragraph 8 and in the event Lessee believes that any such insurance coverage called for under this Lease is insufficient, Lessee shall provide, at its own expense, such additional insurance as Lessee deems adequate.

(h) Anything in this Lease to the contrary notwithstanding, Lessor and Lessee hereby waive and release each other of and from any and all rights of recovery, claims, action or cause of action, against each other, their agents, officers and employees, for any loss or damage that may occur to the Premises, improvements to the building of which the Premises are a part, personal property (building contents) within the building on the Premises, any furniture, equipment, machinery, goods or supplies not covered by this Lease which Lessee may bring or obtain upon the Premises or any additional improvements which Lessee may construct on the Premises, by reason of fire, the elements or any other cause which could be insured against under the terms of all risk property insurance policies, regardless of cause or origin, including negligence of Lessor or Lessee and their agents, officers and employees. Because this Paragraph will preclude the assignment of any claim mentioned in it by way of subrogation (or otherwise) to an insurance company (or any other person) each party to this Lease agrees immediately to give to each insurance company, written notice of the terms of the mutual waivers contained in this Paragraph, and to have the insurance policies properly endorsed if necessary to prevent the invalidation of the insurance coverages by reason of the mutual waivers contained in this Paragraph. Lessee also

waives and releases Lessor, its agents, officers and employees of and from any and all rights of recovery, claim, action or cause of action for any loss or damage insured against under any other policies of insurance carried by Lessee.

(i) Lessee shall pay to Lessor during the term hereof, additional rent in the amount of any premiums for the insurance obtained under Paragraphs 8(c)(i), 8(c)(ii), and 8(c)(iii) and any other insurance which Lessor or Lessor's lender deems necessary for the Premises and the amount of any deductibles paid by Lessor under such policies. If Lessor elects to self-insure or includes the Premises under blanket insurance policies covering multiple properties, then Lessee's reimbursement obligation hereunder shall include the portion of the reasonable cost of such self-insurance or blanket insurance that is allocated to the Premises. Lessee shall pay any such premiums to Lessor within thirty (30) days after receipt by Lessee of a copy of the premiums statement or other evidence of the amount due. If the insurance policies maintained hereunder cover other improvements in addition to the Premises, Lessor shall also deliver to Lessee a statement of the amount of such premiums attributable to the Premises and showing in reasonable detail the manner in which such amount was computed. If the term of this Lease shall not expire concurrently with the expiration of the period covered by such insurance, Lessee's liability for premiums shall be prorated on an annual basis.

(j) Lessor may also maintain commercial general liability insurance in addition to, and not in lieu of, the commercial general liability insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein. If Lessor maintains such insurance, Lessee shall pay to Lessor during the term of this Lease additional rent in the amount of any premiums for such insurance in the same manner as provided in Paragraph 8(i). All insurance to be carried by Lessee shall be primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only.

(k) Lessor shall not be liable for injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessee's employees, contractors, invitees, customers, or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, air conditioning or lighting fixtures, or from any other cause, whether said injury or damage results from conditions arising upon the Premises or upon other portions of the building of which the Premises are a part, from other sources or places, and regardless of whether the cause of such damage or injury or the means of repairing the same is accessible or not. Lessor shall not be liable for any damages arising from any act or neglect of any other tenant or Lessor or

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the failure by Lessor to enforce the provisions of any other lease in the Industrial Center. Notwithstanding Lessor's negligence or breach of this Lease, Lessor shall under no circumstances be liable for injury to Lessee's business or for any loss of income or profit therefrom.

## 9. Damage or Destruction

### 9.1 Definitions.

(a) "Premises Partial Damage" shall herein mean damage or destruction to the Premises to the extent that the cost of repair is less than 50% of the then replacement cost of the Premises. "Premises Building Partial Damage" shall herein mean damage or destruction to the building of which the Premises are a part to the extent that the cost of repair is less than 50% of the then replacement cost of such building as a whole.

(b) "Premises Total Destruction" shall herein mean damage or destruction to the Premises to the extent that the cost of repair is 50% or more of the then replacement cost of the Premises. "Premises Building Total Destruction" shall herein mean damage or destruction to the building of which the Premises are a part to the extent that the cost of repair is 50% or more of the then replacement cost of such building as a whole.

(c) "Insured Loss" shall herein mean damage or destruction which was caused by an event required to be covered by the insurance described in Paragraph 8.

9.2 Partial Damage - Insured Loss. Subject to the provisions of Paragraphs 9.4, 9.5 and 9.6, if at any time during the term of this Lease there is damage which is an Insured Loss and which falls into the classification of Premises Partial Damage or Premises Building Partial Damage, then Lessor shall, at Lessor's expense, repair such damage, but not Lessee's fixtures, equipment or tenant improvements unless the same have become a part of the Premises pursuant to Paragraph 7.5 hereof as soon as reasonably possible and this Lease shall continue in full force and effect. Notwithstanding the above, if the insurance proceeds received by Lessor are not sufficient to effect such repair, Lessor shall give notice to Lessee of the amount required in addition to the insurance proceeds to effect such repair. Lessee shall contribute the required amount to Lessor within ten days after Lessee has received notice from Lessor of the shortage in the insurance. When Lessee shall contribute such amount to Lessor, Lessor shall make such repairs as soon as reasonably possible and

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this Lease shall continue in full force and effect. Lessee shall in no event

have any right to reimbursement for any such amounts so contributed.

9.3 Partial Damage - Uninsured Loss. Subject to the provisions of Paragraphs 9.4, 9.5 and 9.6, if at any time during the term of this Lease there is damage which is not an Insured Loss and which falls within the classification of Premises Partial Damage or Premises Building Partial Damage, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessee's expense), Lessor may at Lessor's option either (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) give written notice to Lessee within thirty (30) days after the date of the occurrence of such damage of Lessor's intention to cancel and terminate this Lease, as of the date of the occurrence of such damage. In the event Lessor elects to give such notice of Lessor's intention to cancel and terminate this Lease, Lessee shall have the right within thirty (30) days after the receipt of such notice to give written notice to Lessor of Lessee's intention to repair such damage at Lessee's expense, without reimbursement from Lessor, in which event this Lease shall continue in full force and effect, and Lessee shall proceed to make such repairs as soon as reasonably possible. If Lessee does not give such notice within such 10-day period this Lease shall be canceled and terminated as of the date of the occurrence of such damage.

9.4 Total Destruction. If at any time during the term of this Lease there is damage, whether or not an Insured Loss, (including destruction required by any authorized public authority), which falls into the classification of Premises Total Destruction or Premises Building Total Destruction, this Lease shall automatically terminate as of the date of such total destruction.

9.5 Damage Near End of Term.

(a) If at any time during the last six months of the term of this Lease there is damage, whether or not an Insured Loss, which falls within the classification of the Premises Partial Damage, Lessor may at Lessor's option cancel and terminate this Lease as of the date of occurrence of such damage by giving written notice to Lessee of Lessor's election to do so within 30 days after the date of occurrence of such damage.

(b) Notwithstanding Paragraph 9.5(a) in the event that Lessee has an option to extend or renew this Lease, and the time within which said option may be exercised has not yet expired, Lessee shall exercise such option, if it is to be exercised at all, no later than 20 days after the occurrence of an Insured Loss falling within the classification of Premises Partial Damage during the last six months of the term of this

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Lease. If Lessee duly exercises such option during said 20 day period, Lessor shall, at Lessor's expense, repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect, provided Lessee first deposits with Lessor any shortfall in necessary funds. If Lessee fails to exercise such option during said 20 day period, then Lessor may at Lessor's option terminate and cancel this Lease as of the expiration of said 20 day period by giving written notice to Lessee of Lessor's election to do so within 10 days after the expiration of said 20 day period, notwithstanding any term or provision in the grant of option to the contrary.

9.6 Abatement of Rent: Lessee's Remedies.

(a) In the event of damage described in Paragraphs 9.2, 9.3 or 9.5 and Lessor or Lessee repairs or restores the Premises pursuant to the provisions of paragraph 9, the rent payable hereunder for the period during which such damage, repair or restoration continues shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired. Except for abatement of rent, if any, Lessee shall have no claim against Lessor for any damage suffered by reason of any such damage, destruction, repair or restoration.

(b) If Lessor shall be obligated to repair or restore the Premises under the provisions of Paragraph 9 and shall not commence such repair or restoration within 90 days after such obligations shall accrue, Lessee may at Lessee's option cancel and terminate this Lease by giving Lessor written notice of Lessee's election to do so at any time prior to the commencement of such

repair or restoration. In such event this Lease shall terminate as of the date of such notice.

9.7 Termination - Advance Payments. Upon termination of this Lease pursuant to Paragraph 9, an equitable adjustment shall be made concerning advance rent and any advance payments made by Lessee to Lessor. Lessor shall, in addition, return to Lessee so much of Lessee's security deposit as has not theretofore been applied by Lessor.

9.8 Waiver. Lessor and Lessee waive the provisions of any statutes which relate to termination of leases when leased property is destroyed and agree that such event shall be governed by the terms of this Lease.

9.9 Causeway. Notwithstanding anything to the contrary in this Lease, Lessor shall have no obligation to repair, restore or reconstruct any portion of the Causeway.

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## 10. Real Property Taxes.

10.1 Taxes. Lessee shall pay the real property tax, as defined in Paragraph 10.2, applicable to the Premises during the term of this Lease. All such payments shall be made at least ten (10) days prior to the delinquency date of such payment. Lessee shall promptly furnish Lessor with satisfactory evidence that such taxes have been paid. If any such taxes paid by Lessee shall cover any period of time prior to or after the expiration of the term hereof, Lessee's share of such taxes shall be equitably prorated to cover only the period of time within the tax fiscal year during which this Lease shall be in effect, and Lessor shall reimburse Lessee to the extent required. If Lessee shall fail to pay any such taxes, Lessor shall have the right to pay the same, in which case Lessee shall repay such amount to Lessor with Lessee's next rent installment together with interest at the maximum rate then allowable by law.

10.2 Definition of "Real Property Tax". As used herein, the term "real property tax" shall include any form of real estate tax or assessment, general, special, ordinary or extraordinary, and any license fee, commercial rental tax, improvement bond or bonds, levy or tax (other than inheritance, personal income or estate taxes) imposed on the Premises by any authority having the direct or indirect power to tax, including any city, state or federal government, or any school, agricultural, sanitary, fire, street, drainage or other improvement district thereof, as against any legal or equitable interest of Lessor in the Premises or in the real property of which the Premises are a part, as against Lessor's right to rent or other income therefrom, and as against Lessor's business of leasing the Premises. The term "real property tax" shall also include any tax, fee, levy, assessment or charge (a) in substitution of, partially or totally, any tax, fee, levy, assessment or charge hereinabove included within the definition of "real property tax," or (b) the nature of which was hereinbefore included within the definition of "real property tax," or (c) which is imposed for a service or right not charged prior to June 1, 1978, or, if previously charged, has been increased since June 1, 1978, or (d) which is imposed as a result of a transfer, either partial or total, of Lessor's interest in the Premises or which is added to a tax or charge hereinbefore included within the definition of real property tax by reason of such transfer, or (e) which is imposed by reason of this transaction, any modifications or changes hereto, or any transfers hereof.

10.3 Joint Assessment. If the Premises are not separately assessed, Lessee's liability shall be an equitable proportion of the real property taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available. Lessor's reasonable determination thereof, in good faith, shall be conclusive.

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10.4 Additional Provisions Regarding Real Property Taxes. Lessor shall have the option to pay the real property taxes, and in such case, Lessee shall, as additional rent for the Premises, pay for cost of all real property taxes paid hereunder. If Lessor pays the real property taxes, Lessee shall, within ten (10) days following demand by Lessor, reimburse Lessor for the cost of the real

property taxes so paid. Lessor shall have the right to contest or appeal any real property taxes or assessments applicable to the Premises and to seek a reduction in the assessed valuation of the Premises (collectively, "Tax Contests"). Any refund of real property taxes resulting from any such Tax Contest shall be applied first to reimburse Lessor for its costs and expenses in connection with the Tax Contest (including, without limitation attorneys' fees and the costs of consultants) (collectively, the "Tax Contest Costs") and then, out of and to the extent of the balance of such refund, Lessor shall reimburse to Lessee the portion of such reduction attributable to the Premises and the term of this Lease, if previously paid by Lessee. Lessor shall equitably allocate the Tax Contest Costs between those years covered by the Tax Contest that are outside of the term of this Lease and those years covered by the Tax Contest that are within the term of this Lease.

#### 10.5 Personal Property Taxes.

(a) Lessee shall pay prior to delinquency all taxes assessed against and levied upon trade fixtures, furnishings, equipment and all other personal property of Lessee contained in the Premises or elsewhere. When possible, Lessee shall cause said trade fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor.

(b) If any of Lessee's said personal property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee within 10 days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. Utilities. Lessee shall pay for all water, gas, heat, light, power, telephone and other utilities and services supplied to the Premises, together with any taxes thereon. If any such services are not separately metered to Lessee, Lessee shall pay a reasonable proportion to be determined by Lessor of all charges jointly metered with other premises.

#### 12. Assignment and Subletting.

12.1 Lessor's Consent Required. Lessee shall not voluntarily or by operation of law assign, transfer, mortgage, sublet, or otherwise transfer or encumber all or any part

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of Lessee's interest in this Lease or in the Premises, without Lessor's prior written consent, which Lessor shall not unreasonably withhold. Lessor shall respond to Lessee's request for consent hereunder in a timely manner and any attempted assignment, transfer, mortgage, encumbrance or subletting without such consent shall be void, and shall constitute a noncurable breach of this Lease, without the need for notice to Lessee under Paragraph 13.1.

12.2 Procedure. If at any time or from time to time during the term of this Lease, Lessee desires to assign or sublet all or any part of Lessee's interest in this Lease or in the Premises, Lessee shall give prior written notice to Lessor setting forth the terms of the proposed assignment or subletting and the space so proposed to be assigned or sublet. Lessor shall have the option, exercisable by notice given to Lessee within twenty (20) days after Lessee's notice is given, either to sublet from Lessee such space at the rental and other terms set forth in Lessee's notice, or if the proposed subletting is for the entire Premises for the balance of the term of the Lease, to terminate this Lease. If Lessor does not exercise such option and Lessor grants its consent to the proposed assignment or sublease as provided in Paragraph 12.1, Lessee shall be free to assign or sublet such space to any third party. Such assignment or sublease shall be subject to, without limitation, all the conditions in Paragraph 12 and the following conditions:

(a) The assignment or sublease shall be on the terms set forth in the notice given to Lessor. Any subsequent changes or modifications will require Lessor's prior written consent.

(b) Lessee acknowledges that Lessor's agreement to lease these Premises to Lessee at the rent and terms stated herein is made in material reliance upon Lessor's evaluation of this particular Lessee's background, experience and ability, as well as the nature of the use of the Premises by this

Lessee as set forth in Paragraph 6. In the event that Lessee shall request Lessor's written consent to assign or sublease the Premises as required in Paragraphs 12.1 and 12.2 hereof, then each such request for consent shall be accompanied by the following:

(i) Financial statements of the proposed assignee or sublessee;

(ii) A statement of the specific uses for which the Premises will be utilized by the proposed assignee or sublessee; and

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(iii) Preliminary plans prepared by an architect or civil engineer for all alterations to the Premises that are contemplated to be made by Lessee, the proposed assignee or sublessee.

(c) No assignment or sublease shall be valid and no assignee or sublessee shall take possession of the Premises assigned or subleased until an executed counterpart of such assignment or sublease has been delivered to Lessor.

(d) No sublessee or assignee shall have a right further to sublet or assign.

(e) 50% (after deduction of reasonable real estate brokerage commission paid by Lessee) of any sums or other economic consideration received by Lessee as a result of such assignment or subletting (except rental or other payments received which are attributable to amortization of the cost of leasehold improvements other than building standard tenant improvements made to the assigned or sublet portion of the Premises by Lessor) whether denominated rentals under the assignment or sublease or otherwise, which exceed, in the aggregate, the total sums which Lessee is obligated to pay Lessor under this Lease (prorated to reflect obligations allocable to that portion of the Premises subject to such assignment or sublease) shall be payable to Lessor as additional rental under this Lease without affecting or reducing any other obligation of Lessee hereunder. In the event of subletting of only a portion of the Premises, in calculating whether the rent received by Lessee exceeds the rent payable under this Lease, the rent payable under the Lease shall be prorated according to the square footage involved in order to reflect the rent applicable to the space sublet

### 12.3 Lessees Other Than Individuals.

(a) If Lessee is a partnership, a transfer of any interest of a general partner, a withdrawal of any general partner from the partnership, or the dissolution of the partnership, shall be deemed to be an assignment of this Lease.

(b) If Lessee is a corporation, unless Lessee is a public corporation whose stock is regularly traded on a national stock exchange, or is regularly traded in the over-the-counter market and quoted on NASDAQ, any sale or other transfer of a percentage of capital stock of Lessee which results in a change of controlling persons, or the sale or other transfer of substantially all of the assets of Lessee, shall be deemed to be an assignment of this Lease.

12.4 Lessee Affiliate. Notwithstanding the provisions of Paragraph 12.1 hereof, Lessee may assign or sublet the Premises, or any portion thereof, without

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Lessor's consent to any corporation which controls, is controlled by or is under common control with Lessee, or to any corporation resulting from the merger or consolidation with Lessee, or to any person or entity which acquires all the assets of Lessee as a going concern of the business that is being conducted on the Premises, provided that (a) the transferee has a net worth, after the assignment or sublet, which is equal to or greater than the lower of (i) the net worth of Lessee at the date of this Lease and (ii) the net worth of Lessee

immediately prior to the transfer, (b) the transferee assumes, in full, the obligations of Lessee under this Lease; and (c) a copy of the document effecting the sublet and evidencing the transferee's assumption of Lessee's obligations hereunder is promptly delivered to Lessor. Any such assignment shall not, in any way, affect or limit the liability of Lessee under the terms of this Lease even if after such assignment or subletting the terms of this Lease are materially changed or altered without the consent of Lessee, the consent of whom shall not be necessary.

12.5 No Release of Lessee. Regardless of Lessor's consent, any subletting or assignment shall not (a) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (b) release Lessee of any of Lessee's obligations hereunder or (c) alter the primary liability of Lessee to pay the rent and to perform all other obligations to be performed by Lessee hereunder. The acceptance of rent by Lessor from any other person shall not be deemed to be a waiver by Lessor of any provision hereof or any default by Lessee. Consent to one assignment or subletting shall not be deemed consent to any subsequent assignment or subletting. In the event of default by any assignee of Lessee or any successor of Lessee, in the performance of any of the terms hereof, Lessor may proceed directly against Lessee without the necessity of exhausting remedies against said assignee. Lessor may consent to subsequent assignments or subletting of this Lease or amendments or modifications to this Lease with assignees of Lessee, without notifying Lessee, or any successor of Lessee, and without obtaining its or their consent thereto and such action shall not relieve Lessee of liability under this Lease.

12.6 Assignment to Lessor. Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all rentals and income arising from any sublease heretofore or hereafter made by Lessee, and Lessor may collect such rent and income and apply same toward Lessee's obligations under this Lease; provided however, that until a default shall occur in the performance, of Lessee's obligations under this Lease, and subject to Paragraph 12.2(e) Lessee may receive, collect and enjoy the rents accruing under such sublease. Lessor shall not, by reason of this or any other assignment of such sublease to Lessor nor by reason of the collection of the rents from a sublessee, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee under such sublease. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice

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from Lessor stating that a default exists in the performance of Lessee's obligations under this Lease, to pay to Lessor the rents due and to become due under the sublease. Lessee agrees that such sublessee shall have the right to rely upon any such statement and request from Lessor, and that such sublessee shall pay such rents to Lessor without any obligation or right to inquire as to whether such default exists and notwithstanding any notice from or claim from Lessee to the contrary. Lessee shall have no right or claim against such sublessee or Lessor for any such rents so paid by said sublessee to Lessor.

12.7 Attorney's Fees. In the event Lessee shall assign or sublet the Premises or request the consent of Lessor to any assignment or subletting or if Lessee shall request the consent of Lessor for any act Lessee proposes to do, then Lessee shall pay Lessor's reasonable attorneys' fees incurred in connection therewith, such attorneys' fees not to exceed \$350.00 for each such request. Notwithstanding the foregoing, the parties agree that a payment of \$750.00 is a reasonable fee for Lessor's review of Lessee's request to assign or sublease.

### 13. Defaults: Remedies.

13.1 Defaults. The occurrence of any one or more of the following events shall constitute a material default and breach of this Lease by Lessee:

(a) The vacating or abandonment of the Premises by Lessee.

(b) The failure by Lessee to make any payment of rent or any other payment required to be made by Lessee hereunder, as and when due, where such failure shall continue for a period of three days after written notice thereof from Lessor to Lessee. In the event that Lessor serves Lessee with a Notice to Pay Rent or Quit pursuant to applicable Unlawful Detainer statutes, such Notice to Pay Rent or Quit shall also constitute the notice required by

this subparagraph.

(c) The failure by Lessee to observe or perform any of the covenants, conditions or provisions of this Lease to be observed or performed by Lessee, other than described in paragraph (b) above, where such failure shall continue for a period of 30 days after written notice thereof from Lessor to Lessee; provided, however, that if the nature of Lessee's default is such that more than 30 days are reasonably required for its cure, then Lessee shall not be deemed to be in default if Lessee commenced such cure within said 30-day period and thereafter diligently prosecutes such cure to completion. To the extent permitted by law, said thirty (30) day notice shall constitute the sole and exclusive notice required to be given to Lessee under applicable unlawful detainer statutes.

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(d) (i) The making by Lessee of any general arrangement or assignment for the benefit of creditors; (ii) Lessee becomes a "debtor" as defined in 11 U.S.C. Section 101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within 60 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where possession is not restored to Lessee within 30 days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged within 30 days. Provided, however, in the event that any provision of this Paragraph 13.1(d) is contrary to any applicable law, such provision shall be of no force or effect.

(e) The discovery by Lessor that any financial statement given to Lessor by Lessee, any assignee of Lessee, any subtenant of Lessee, any successor in interest of Lessee or any guarantor of Lessee's obligations hereunder, and any of them, was materially false.

(f) If the performance of Lessee's obligations under this Lease is guaranteed: (i) the death of a guarantor, (ii) the termination of a guarantor's liability with respect to this Lease other than in accordance with the terms of such guaranty, (iii) a guarantor's becoming insolvent or the subject of a bankruptcy filing, (iv) a guarantor's refusal to honor the guaranty, or (v) a guarantor's breach of its guaranty obligation on an anticipatory breach basis, and Lessee's failure, within sixty (60) days following written notice by or on behalf of Lessor to Lessee of any such event, to provide Lessor with written alternative assurance or security, which, when coupled with the then existing resources of Lessee, equals or exceeds the combined financial resources of Lessee and the guarantors that existed at the time of execution of this Lease.

13.2 Remedies. If Lessee fails to perform any affirmative duty or obligation of Lessee under this Lease, within ten (10) days after written notice to Lessee (or in case of an emergency, without notice), Lessor may at its option (but without obligation to do so), perform such duty or obligation on Lessee's behalf including but not limited to the obtaining of reasonably required bonds, insurance policies, or governmental licenses, permits or approvals. The costs and expenses of any such performance by Lessor shall be due and payable by Lessee to Lessor upon invoice therefor. In the event of a breach of this Lease by Lessee, as defined in Paragraph 13.1, with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such breach, Lessor may:

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(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease and the term hereof shall terminate and Lessee shall immediately surrender possession of the Premises to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the worth at the time of the award of the unpaid rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the term after the of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided;



and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by the Lessee's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, including but not limited to the cost of recovering possession of the Premises, expenses of reletting including necessary renovation and alteration of the Premises, reasonable attorneys' fees, and that portion of the leasing commission paid by Lessor applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provisions (i) and (ii) of the prior sentence shall be calculated based on an interest rate equal to the highest rate permitted by applicable law. The worth at the time of award of the amount referred to in provision (iii) of the prior sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus one percent. Efforts by Lessor to mitigate damages caused by Lessee's breach of this Lease shall not waive Lessor's right to recover damages under this Paragraph. If termination of this Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding the unpaid rent and damages as are recoverable therein, or Lessor may reserve therein the right to recover all or any part thereof in a separate suit for such rent and/or damages. If a notice and grace period required under Paragraphs 13.1(b), (c) or (d) was not previously given, a notice to pay rent or quit, or to perform or quit, as the case may be, given to Lessee under any statute authorizing the forfeiture of leases for unlawful detainer shall also constitute the applicable notice for grace period purposes required by subparagraphs 13.1 (b), (c) or (d). In such case, the applicable grace period under Paragraphs 13.1(b), (c) or (d) and under the unlawful detainer statute shall run concurrently after the one such statutory notice, and the failure of Lessee to cure the default within the greater of the two such grace periods shall constitute both an unlawful detainer and breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession in effect (in California under California Civil Code Section 1951.4) after Lessee's breach and abandonment and recover the rent as it becomes due, provided Lessee has the right to

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sublet or assign, subject only to reasonable limitations. See Paragraphs 12 and 36 for the limitations on assignment and subletting which limitations Lessee and Lessor agree are reasonable. Acts of maintenance or preservation, efforts to relet the Premises, or the appointment of a receiver to protect the Lessor's interest under the Lease, shall not constitute a termination of the Lessee's right to possession.

(c) Pursue any other remedy now or hereafter available to Lessor under the laws or judicial decisions of the State of California. Unpaid installments of rent and other unpaid monetary obligations of Lessee under the terms of this Lease shall bear interest from the date due at the maximum rate allowed by law.

(d) The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

13.3 Default by Lessor. Lessor shall not be in default unless Lessor fails to perform obligations required of Lessor within a reasonable time, but in no event later than thirty (30) days after written notice by Lessee to Lessor and to the holder of any first mortgage or deed of trust encumbering the Premises whose name and address shall have theretofore been furnished to Lessee in writing, specifying wherein Lessor has failed to perform such obligation; provided, however, that if the nature of Lessor's obligation is such that more than thirty (30) days are required for performance then Lessor shall not be in

default if Lessor commences performance within such 30-day period and thereafter diligently prosecutes the same to completion. Any damages or judgments arising out of Lessor's default of its obligations under this Lease shall be satisfied only out of Lessor's interest and estate in the Premises, and Lessor shall have no personal liability beyond such interest and estate with respect to such damages or judgments.

13.4 Late Charges. Lessee hereby acknowledges that late payment by Lessee to Lessor of rent and other sums due hereunder will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed on Lessor by the terms of any mortgage or trust deed encumbering the Premises. Accordingly, if any installment of rent or any other sum due from Lessee shall not be received by Lessor or Lessor's designee within ten (10) days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall pay to Lessor a late charge equal to 6% of such overdue amount. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of late payment by

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Lessee. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's default with respect to such overdue amount, not prevent Lessor from exercising any of the other rights and remedies granted hereunder. In the event that a late charge is payable hereunder, whether or not collected, for three (3) consecutive installments of rent, then rent shall automatically become due and payable quarterly in advance, rather than monthly, notwithstanding Paragraph 4 or any other provision of this Lease to the contrary.

13.5 Impounds. In the event that a late charge is payable hereunder, whether or not collected, for three (3) installments of rent or any other monetary obligation of Lessee under the terms of this Lease, Lessee shall pay to Lessor, if Lessor shall so request, in addition to any other payments required under this Lease, a monthly advance installment, payable at the same time as the monthly rent, as estimated by Lessor, for real property tax and insurance expenses on the Premises which are payable by Lessee under the terms of this Lease. Such fund shall be established to insure payment when due, before delinquency, of any or all such real property taxes and insurance premiums. If the amounts paid to Lessor by Lessee under the provisions of this paragraph are insufficient to discharge the obligations of Lessee to pay such real property taxes and insurance premiums as the same become due, Lessee shall pay to Lessor, upon Lessor's demand, such additional sums necessary to pay such obligations. All moneys paid to Lessor under this paragraph may be intermingled with other moneys of Lessor and shall not bear interest. In the event of a default in the obligations of Lessee to perform under this Lease, then any balance remaining from funds paid to Lessor under the provisions of this paragraph may, at the option of Lessor, be applied to the payment of any monetary default of Lessee in lieu of being applied to the payment of real property tax and insurance premiums.

14. Condemnation. If the Premises or any portion thereof are taken under the power of eminent domain, or sold under the threat of the exercise of said power (all of which are herein called "condemnation"), this Lease shall terminate as to the part so taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than 10% of the floor area of the building on the Premises, or more than 25% of the land area of the Premises which is not occupied by any building, is taken by condemnation, Lessee may, at Lessee's option, to be exercised in writing only within ten (10) days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within ten (10) days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the

portion of the Premises remaining, except that the rent shall be reduced in the proportion that the floor area of the building taken bears to the total floor area of the building situated on

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the Premises. No reduction of rent shall occur if the only area taken is that which does not have a building located thereon. Any award for the taking of all or any part of the Premises under the power of eminent domain or any payment made under threat of the exercise of such power shall be the property of Lessor, whether such award shall be made as compensation for diminution in value of the leasehold or for the taking of the fee, or as severance damages; provided, however, that Lessee shall be entitled to any award for loss of or damage to Lessee's trade fixtures and removable personal property. In the event that this Lease is not terminated by reason of such condemnation, Lessor shall to the extent of net severance damages received by Lessor in connection with such condemnation, over and above the legal and other expenses incurred by Lessor in the condemnation matter, repair any damage to the Premises caused by such condemnation except to the extent that Lessee has been reimbursed therefor by the condemning authority. Lessee shall pay any amount in excess of such net severance damages required to complete such repair.

15. Broker's Commissions. Lessee and Lessor each represent and warrant to the other that neither has had any dealings with any person, firm, broker or finder (other than those persons, if any, whose names are set forth in this Paragraph 15) in connection with the negotiation of this Lease and/or the consummation of the transaction contemplated hereby, and no other broker or other person, firm or entity is entitled to any commission or finder's fee in connection with said transaction and Lessee and Lessor do each hereby indemnify and hold the other harmless from and against any costs, expenses, attorneys' fees or liability for compensation, commission or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying party. Named brokers:

Lessor's Broker: None  
Lessee's Broker: CB Commercial Real Estate Group

The commission payable to Lessee's Broker with respect to this Lease shall be pursuant to the terms of the separate commission agreement (the "Separate Agreement") in effect between Lessor and Lessee's Broker. Nothing in this Lease shall impose any obligation on Lessor to pay a commission or fee (a) to any party other than Lessee's Broker or (b) to any party with respect to (i) the exercise by Lessee of any option or right of first refusal pursuant to this Lease (except as provided in the Separate Agreement), or (ii) any extension or renewal of this Lease.

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16. Estoppel Certificate.

(a) Lessee shall at any time upon not less than ten (10) days' prior written notice from Lessor execute, acknowledge and deliver to Lessor a statement in writing (i) certifying that this Lease is unmodified and in full force and effect (or, if modified, stating the nature of such modification and certifying that this Lease, as so modified, is in full force and effect) and the date to which the rent and other charges are paid in advance, if any, and (ii) acknowledging that there are not, to Lessee's knowledge, any uncured defaults on the part of Lessor hereunder, or specifying such defaults if any are claimed. Any such statement may be conclusively relied upon by any prospective purchaser or encumbrancer of the Premises.

(b) At Lessor's option, Lessee's failure to deliver such statement within such time shall be a material breach of this Lease or shall be conclusive upon Lessee (i) that this Lease is in full force and effect, without modification except as may be represented by Lessor, (ii) that there are no

uncured defaults in Lessor's performance, and (iii) that not more than one month's rent has been paid in advance or such failure may be considered by Lessor as a default by Lessee under this Lease.

(c) If Lessor desires to finance, refinance, or sell the Premises, or any part thereof Lessee hereby agrees to deliver to any lender or purchaser designated by Lessor such financial statements of Lessee as may be reasonably required by such lender or purchaser. Such statements shall include the past three years' financial statements of Lessee. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. Lessor's Liability. The term "Lessor" as used herein shall mean only the owner or owners at the time in question of the fee title or a lessee's interest in a ground lease of the Premises, and in the event of any transfer of such title or interest, Lessor herein named (and in case of any subsequent transfers then the grantor) shall be relieved from and after the date of such transfer of all liability as respects Lessor's obligations thereafter to be performed, provided that any funds in the hands of Lessor or the then grantor at the time of such transfer, in which Lessee has an interest, shall be delivered to the grantee. The obligations contained in this Lease to be performed by Lessor shall, subject as aforesaid, be binding on Lessor's successors and assigns, only during their respective periods of ownership.

18. Severability. The invalidity of any provision of this Lease as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

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19. Interest on Past-due Obligations. Except as expressly herein provided, any amount due to Lessor not paid when due shall bear interest at the maximum rate then allowable by law from the date due. Payment of such interest shall not excuse or cure any default by Lessee under this Lease, provided, however, that interest shall not be payable on late charges incurred by Lessee nor on any amounts upon which late charges are paid by Lessee.

20. Time of Essence. Time is of the essence.

21. Additional Rent. Any monetary obligations of Lessee to Lessor under the terms of this Lease shall be deemed to be rent.

22. Incorporation of Prior Agreements: Amendments. This Lease contains all agreements of the parties with respect to any matter mentioned herein. No prior agreement or understanding pertaining to any such matter shall be effective. This Lease may be modified in writing only, signed by the parties in interest at the time of the modification. Except as otherwise stated in this Lease, Lessee hereby acknowledges that neither the real estate broker listed in Paragraph 15 hereof nor any cooperating broker on this transaction nor the Lessor or any employees or agents of any of said persons has made any oral or written warranties or representations to Lessee relative to the condition or use by Lessee of said Premises and Lessee acknowledges that Lessee assumes all responsibility regarding the Occupational Safety Health Act, the legal use and adaptability of the Premises and the compliance thereof with all applicable laws and regulations in effect during the term of this Lease except as otherwise specifically stated in this Lease.

23. Notices. Any notice given pursuant to this Lease shall be in writing, shall be personally delivered, delivered by Federal Express or comparable overnight courier, providing written evidence of delivery, or delivered by U.S. registered or certified mail, return receipt requested, postage prepaid and sent to Lessor and Lessee at the following addresses:

LESSOR:

Prudential Real Estate Investors  
2029 Century Park East  
Suite 2050  
Los Angeles, California 90067

Attn: Regional Counsel

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With a copy by the same method to:

The Prudential Real Estate Investors  
c/o Cushman & Wakefield of California, Inc.  
555 South Flower Street, Suite 4200  
Los Angeles, CA 90017-2413  
Attn: Mark Harryman

LESSEE:

Skechers USA, Inc.  
228 Manhattan Beach Blvd. #200  
Manhattan Beach, CA 90266  
Attn: David Weinberg

With a copy by the same method to:

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or such other address as either party may from time to time designate as its notice address by notifying the other party thereof. Notice so sent shall be deemed given (a) when personally delivered, or (b) on the first business day following deposit with Federal Express or a comparable overnight courier service providing written evidence of delivery, or (c) five business days following deposit in the United States mail, if notice is sent by registered or certified mail, return receipt requested, postage prepaid. A copy of all notices required or permitted to be given to Lessor hereunder shall be concurrently transmitted to such party or parties at such addresses as Lessor may from time to time hereafter designate by notice to Lessee.

24. Waivers. No waiver by Lessor of any provision hereof shall be deemed a waiver of any other provision hereof or of any subsequent breach by Lessee of the same or any other provision. Lessor's consent to, or approval of any act shall not be deemed to render unnecessary the obtaining of Lessor's consent to or approval of any subsequent act by Lessee. The acceptance of rent hereunder by Lessor shall not be a waiver of any preceding breach by Lessee of any provision hereof, other than the failure of Lessee to pay the particular rent so accepted, regardless of Lessor's knowledge of such preceding breach at the time of acceptance of such rent.

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25. No Recording. Lessee shall not record this Lem.

26. Holding Over. If Lessee, with Lessor's consent remains in possession of the Premises or any part thereof after the expiration of the term hereof, such occupancy shall be a tenancy from month to month upon all the provisions of this Lease pertaining to the obligations of Lessee, except that the monthly rent shall be 150% of the rent payable in the last month of the Lease term, but all options and rights of first refusal, if any, granted under the terms of this Lease shall be deemed terminated and be of no further effect during said month to month tenancy.

27. Cumulative Remedies. No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at

law or in equity.

28. Covenants and Conditions. Each provision of this Lease performable by Lessee shall be deemed both a covenant and a condition.

29. Binding Effect: Choice of Law. Subject to any provisions hereof restricting assignment or subletting by Lessee and subject to the provisions of Paragraph 17, this Lease shall bind the parties, their personal representatives, successors and assigns. This Lease shall be governed by the laws of the State wherein the Premises are located.

30. Subordination: Attornment: Non-Disturbance.

30.1 Subordination. This Lease and any Option granted hereby shall be subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively, "Security Device"), now or hereafter placed upon the Premises, to any and all advances made on the security thereof, and to all renewals, modifications, and extensions thereof. Lessee agrees that the holders of any such Security Devices (in this Lease together referred to as "Lessor's Lender") shall have no liability or obligation to perform any of the obligations of Lessor under this Lease. Any Lender may elect to have this Lease and/or any Option granted hereby superior to the lien of its Security Device by giving written notice thereof to Lessee, whereupon this Lease and such Options shall be deemed prior to such Security Device, notwithstanding the relative dates of the documentation or recordation thereof. Lessor warrants that there are no Security Devices encumbering the Premises on the date of this Lease

30.2 Attornment. Subject to the non-disturbance provisions of Paragraph 30.3, Lessee agrees to attorn to a Lender or an other party who acquires ownership of the Premises by reason of a foreclosure of a Security Device, and that in the event of such

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foreclosure, such new owner shall not; (i) be liable for any act or omission of any prior lessor or with respect to events occurring prior to acquisition of ownership (provided that this clause (i) shall not relieve the new owner from its ongoing maintenance obligations under this Lease); (ii) be subject to any offsets or defenses which Lessee might have against any prior lessor, or (iii) be bound by prepayment of more than one (1) month's rent

30.3 Non-Disturbance. With respect to Security Devices entered into by Lessor after the execution of this Lease, Lessee's subordination of this Lease shall be subject to receiving a commercially reasonable non-disturbance agreement (a "Non-Disturbance Agreement") from the Lender which Non-Disturbance Agreement provides that Lessee's possession of the Premises, and this Lease, including any options to mend the term hereof, will not be disturbed so long as Lessee is not in breach hereof and attorns to the record owner of the Premises.

30.4 Self-Executing. The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents; provided, however, that upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of the Premises, Lessee and Lessor shall execute such further writings as may be reasonably required to separately document any subordination, attornment and/or Non-Disturbance Agreement provided for herein.

31. Attorney's Fees.

(a) If either party brings an action or proceeding to enforce the terms hereof or declare rights hereunder, the prevailing party in any such proceeding, action, or appeal thereon, shall be entitled to his reasonable attorney's fees and such fees as may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term, "prevailing party" shall include, without limitation, a party who obtains legal counsel or brings an action against the other by reason of the other's breach or default, or who defends such action, and substantially obtains or defeats the relief sought, whether by compromise, settlement, judgment, or abandonment of the claim or defense by the other party.

(b) The attorney's fee award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorney's fees reasonably incurred in good faith.

(c) Lessor shall be entitled to attorney's fees, costs and expenses incurred in the preparation and service of notices of default and consultations in connection therewith, whether or not a legal action is subsequently commenced in

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connection with such default. Lessor and Lessee agree that \$350.00 is a reasonable sum per occurrence for legal services and costs per preparation and service of a notice of default and that Lessor may include \$350.00 as additional rent due in each such notice of default as an amount that must be paid to cure said default.

32. Lessor's Access. Lessor and Lessor's agents shall have the right to enter the Premises at reasonable times for the purpose of inspecting the same, showing the same to prospective purchasers, lenders, or lessees, and making such alterations, repairs, improvements or additions to the Premises or to the building of which they are a part as Lessor may deem necessary or desirable. Lessor may at any time place on or about the Premises any ordinary "For Sale" signs and Lessor may at any time during the last 120 days of the term hereof place on or about the Premises any ordinary "For Lease" signs, all without rebate of rent or liability to Lessee.

33. Auctions. Lessee shall not conduct, nor permit to be conducted, either voluntarily or involuntarily, any auction upon the Premises without first having obtained Lessor's prior written consent. Notwithstanding anything to the contrary in this Lease, Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to grant such consent.

34. Signs. Lessee shall not place any sign upon the Premises without Lessor's prior written consent.

35. Merger. The voluntary or other surrender of this Lease by Lessee, or a mutual cancellation thereof, or a termination by Lessor, shall not work a merger, and shall, at the option of Lessor, terminate all or any existing subtenancies or may, at the option of Lessor, operate as an assignment to Lessor of any or all of such subtenancies.

36. Consents. Except for Paragraphs 33, 34 and 47 hereof, wherever in this Lease the consent of one party is required to an act of the other party, such consent shall not be unreasonably withheld.

37. Guarantor. In the event that there is a guarantor of this Lease, said guarantor shall have the same obligations as Lessee under this Lease.

38. Quiet Possession. Upon Lessee paying the rent for the Premises and observing and performing all of the covenants, conditions and provisions on Lessee's part to be observed and performed hereunder, Lessee shall have quiet possession of the Premises for the entire term hereof subject to all of the provisions of this Lease, and all easements, covenants, conditions and restrictions of record. The individuals executing this Lease on behalf of Lessor represent and warrant to Lessee that they are fully

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authorized and legally capable of executing this Lease on behalf of Lessor and that such execution is binding upon all parties holding an ownership interest in the Premises.

39. Options.

39.1 Definition. As used in this paragraph the word "Options" has the following meaning: (a) the right or option to extend the term of this Lease or to renew this Lease or to extend or renew any lease that Lessee has on other property of Lessor; (b) the option or right of first refusal to lease the Premises or the right of first offer to lease the Premises or the right of first refusal to lease other property of Lessor or the right of first offer to lease other property of Lessor; (c) the right or option to purchase the Premises, or the right of first refusal to purchase the Premises, or the right of first offer to purchase the Premises or the right or option to purchase other property of Lessor, or the right of first refusal to purchase other property of Lessor or the right of first offer to purchase other property of Lessor.

39.2 Options Personal: Multiple Options. Each Option granted to Lessee in this Lease is personal to Lessee and may not be exercised or be assigned, voluntarily or involuntarily, by or to any person or entity other than Lessee, provided, however, the Option may be exercised by or assigned to any Lessee Affiliate as defined in Paragraph 12.4 of this Lease. The Options herein granted to Lessee are not assignable separate and apart from this Lease. In the event that Lessee has any multiple options to extend or renew this Lease a later option cannot be exercised unless the prior option to extend or renew this Lease has been so exercised.

39.3 First Option. Lessor hereby grants to Lessee the option to extend the term of this Lease for a five (5) year period commencing on the date the prior term expires (the "First Option Period") upon each and all of the following terms and conditions:

(a) Lessee gives to Lessor, and Lessor actually receives, on a date which is prior to the date that the First Option Period would commence (if exercised) by at least six (6) and not more than nine (9) months, a written notice of exercise of the option to extend this Lease for said additional term, time being of the essence. If said notification of the exercise of said option is not so given and received, this option shall automatically expire;

(b) The provisions of Paragraph 39, including the provision relating to default of Lessee set forth in Paragraph 39.7, of this Lease are conditions of this option;

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(c) All of the terms and conditions of this Lease except where specifically modified by this option shall apply, except that Lessee shall have no further option to extend the term of this Lease other than for the option provided for in Paragraph 39.4;

(d) Any prior Lessee that has not been expressly released from liability under this Lease, and any guarantor of the Lessee's performance hereunder, expressly reaffirms in writing the extension of their liability for the term of the option; and

(e) The monthly Base Rent for each month of the First option Period shall be the C.P.I. Adjusted Option Rent (as defined below).

39.4 Second Option. Lessor hereby grants to Lessee the option to extend the term of this Lease for a five (5) year period commencing on the date the First Option Period expires (the "Second Option Period") upon each and all of the following terms and conditions:

(a) Lessee gives to Lessor, and Lessor actually receives, on a date which is prior to the date that the Second Option Period would commence (if exercised) by at least six (6) and not more than nine (9) months, a written notice of exercise of the option to extend this Lease for said additional term,



time being of the essence. If said notification of the exercise of said option is not so given and received, this option shall automatically expire;

(b) The provisions of Paragraph 39, including the provision relating to default of Lessee set forth in Paragraph 39.7 of this Lease are conditions of this option;

(c) All of the terms and conditions of this Lease except where specifically modified by this option shall apply, except that Lessee shall have no further option to extend the term of this Lease;

(d) Any prior Lessee that has not been expressly released from liability under this Lease, and any guarantor of the Lessee's performance hereunder, expressly reaffirms in writing the extension of their liability for the term of the option; and

(e) The monthly Base Rent for each month of the option periods shall be the Fair Market Rent of the Premises as of the commencement of the Second Option Period, but in no event less than the monthly Base Rent scheduled to be paid during the month prior to the commencement of the Second Option Period.

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#### 39.5 Fair Market Rent

(a) The term "Fair Market Rent" as used in this Lease is defined to mean the rent, including all escalations, at which tenants are leasing non-sublease, non-encumbered, non-equity space comparable in size and quality to the Premises for the Option Period as to which Fair Market Rent is being determined in the Inland Empire West area, giving appropriate consideration to the annual rental rates per square foot and the standard of measurement by which the square footage is measured. In determining Fair Market Rent it shall be assumed that:

(i) The Premises are in excellent condition and repair and there shall be no deduction for depreciation, obsolescence or deferred maintenance (but less reasonable wear and tear as long as well maintained by Lessee).

(ii) The Premises would be leased for the period of the option being exercised by a tenant with the credit standing of Lessee, as the same exists at that time.

(iii) The Premises would be leased on the same terms of this Lease insofar as the obligations for repair, maintenance, insurance and real estate taxes existed as of the expiration of the original term of this Lease.

(iv) No deduction shall be given nor consideration given to allowances for real estate brokerage commissions or free rent.

(v) The Premises will be used for its highest and best use.

(b) Determination By Lessor. Lessor shall initially determine the Fair Market Rent in each instance, and shall give Lessee notice (the "Market Rent Notice") of such determination and the basis on which such determination was made on or before the 60th day prior to the date on which such determination is to take effect, or as soon thereafter as is reasonably practicable.

(c) Disputes re Fair Market Rent. In the event that Lessee notifies Lessor in writing, on or before the 20th business day following any Market Rent Notice, that Lessee disagrees with the applicable determination, Lessor and Lessee shall negotiate in good faith to resolve such dispute within 10 business days thereafter (The 30th business day after any Market Rent Notice is referred to herein as the

"Outside Agreement Date.") If not resolved by the Outside Agreement Date each party shall submit to the other its determination of Fair Market Rent and the dispute shall be submitted to arbitration in accordance with the following paragraph titled "Arbitration Procedures." Until any such dispute is resolved, any applicable payments due under this Lease shall correspond to Lessor's determination and, if Lessee's determination becomes the final determination, Lessor shall refund any overpayments to Lessee, within 5 business days following the final resolution of the dispute.

(d) Arbitration Procedures.

(i) Lessor and Lessee shall each appoint one arbitrator who shall by profession be a real estate broker who shall have been active over the 5-year period ending on the date of such appointment in the leasing of properties similar to the Premises in the surrounding area of Los Angeles County. The determination of the arbitrators shall be limited solely to the issue of whether Lessor's or Lessee's submitted Fair Market Rent for the Premises is the closest to the actual Fair Market Rent for the Premises as determined by the arbitrators, taking into account the requirements of this subparagraph regarding the same. Each such arbitrator shall be appointed within 15 days after the Outside Agreement Date. Lessor and Lessee may not consult with either such arbitrator prior to resolution.

(ii) The two arbitrators so appointed shall within 15 days of the date of the appointment of the last appointed arbitrator, meet and attempt to reach a decision as to whether the parties shall use Lessor's or Lessee's submitted Fair Market Rent, and shall notify Lessor and Lessee of their decision, if any.

(iii) If the two arbitrators are unable to reach a decision, the two arbitrators shall, within 30 days of the date of the appointment of the last appointed arbitrator, agree upon and appoint a 3rd arbitrator who shall be a broker who shall be qualified under the same criteria set forth hereinabove for qualification of the initial 2 arbitrators.

(iv) The 3 arbitrators shall, within 30 days of the appointment of the 3rd arbitrator, reach a decision as to whether the parties shall use Lessor's or Lessee's submitted Fair Market Rent, and shall notify Lessor and Lessee thereof.

(v) The decision of the majority of the 3 arbitrators shall be binding upon Lessor and Lessee.

(vi) If either Lessor or Lessee fails to appoint an arbitrator within 15 days after the Outside Agreement Date, the arbitrator appointed by one of them shall reach a decision, notify Lessor and Lessee thereof, and such arbitrator's decision shall be binding upon Lessor and Lessee.

(vii) If the 2 arbitrators fail to agree upon and to appoint a 3rd arbitrator, then the appointment of the 3rd arbitrator shall be dismissed, and the matter to be decided shall be forthwith submitted to arbitration under the provisions of the American Arbitration Association, but subject to the instructions set forth in this Lease.

(viii) The cost of arbitration shall be paid by Lessor and Lessee equally.

39.6 C.P.I. Adjusted Option Rent. With respect to any Option Period the "C.P.I. Adjusted Option Rent" shall mean a Base Rent calculated as follows:

(a) As used herein, the term "C.P.I." shall mean the Consumer Price Index of the Bureau of Labor Statistics of the U.S. Department of Labor for Urban Wage Earners and Clerical Workers, Los Angeles-Anaheim-Riverside, California (1982-84=100). With respect to the applicable option period the Base Rent payable as set forth in Paragraph 4 of the line shall be multiplied by a fraction the numerator of which shall be the C.P.I. of the calendar month during which the option period commences, and the denominator of which shall be the C.P.I. for the calendar month in which the original Lease term commenced. The sum so calculated shall constitute the "C.P.I. Adjusted Option Rent" hereunder, subject to Subparagraph 39.6(d), below.

(b) Pending receipt of the required C.P.I. and determination of the actual adjustment, Lessee shall pay an estimated adjusted Base Rent equal to an estimated C.P.I. Adjusted Option Rent, as reasonably determined by Lessor by reference to the then available C.P.I. information. Upon notification of the actual adjustment after publication of the required C.P.I., any overpayment shall be credited against the next installment of rent due, and any underpayment shall be immediately due and payable by Lessee. Lessor's failure to request payment of an estimated or actual rent adjustment shall not constitute a waiver of the right to any adjustment provided for in the Lease or this Paragraph 39.6.

(c) In the event the compilation and/or publication of the C.P.I. shall be transferred to any other governmental department or bureau or agency or shall be

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discontinued, then the index most nearly the same as the C.P.I. (as selected by Lessor) shall be used to make such calculation.

(d) The adjustment(s) required by this Paragraph 39.6 shall be subject to the following additional agreements:

(i) The increase under Paragraph 39.6(b), above, shall be subject to the following minimum and maximum percentage increase per year involved in the adjustment period, on a cumulative and compounded basis:

Minimum yearly percentage increase: 2.5%

Maximum yearly percentage increase: 6%

The "adjustment period" is defined as the period commencing with the month designated in Paragraph 39.6(a), above, as the reference for determining the "denominator", and ending with the month preceding the month designated therein as the reference for determining the "numerator". Should the adjustment period include a partial year, the minimum and maximum percentages shall be prorated for that partial year by multiplying them by a fraction, the numerator of which shall be the number of full calendar months or major portion thereof contained in said partial year, and the denominator of which is twelve (12).

(ii) The new monthly Base Rent shall in no event be less than the rent scheduled to be paid immediately preceding the rent adjustment.

39.7 Effect of Default on Options.

(a) Lessee shall have no right to exercise an Option, notwithstanding any provision in the grant of Option to the contrary, (i) during the time commencing from the date Lessor gives to Lessee a notice of default pursuant to Paragraphs 13.1(b) or 13.1(c) and continuing until the default alleged in said notice of default is cured, or (ii) during the period of time commencing on the day after a monetary obligation to Lessor is due from Lessee and unpaid (without any necessity for notice thereof to Lessee) continuing until the obligation is paid, or (iii) at any time after an event of default described in Paragraphs 13.1(a), 13.1(d), 13.1(e) or 13.1(f) (without any necessity of Lessor to give notice of such default to Lessee), Or (iv) in the event that Lessor has given to Lessee three or more notices of default under Paragraph 13.1(b), where a late charge has become payable under Paragraph 13.4 for each of such

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defaults, or Paragraph 13.1(c), whether or not the defaults are cured, during the 12 month period prior to the time that Lessee intends to exercise the subject Option.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 39.7.

(c) All rights of Lessee under the provisions of an Option shall terminate and be of no further force or effect notwithstanding Lessee's due and timely exercise of the Option, if, after such exercise and during the term of this Lease, (i) Lessee fails to pay to Lessor a monetary obligation of Lessee for a period of 30 days after such obligation becomes due (without any necessity of Lessor to give notice thereof to Lessee), or (ii) Lessee fails to commence to cure a default specified in Paragraph 13.1(c) within 30 days after the date that Lessor gives notice to Lessee of such default and/or Lessee fails thereafter to diligently prosecute said cure to completion, or (iii) Lessee commits a default described in Paragraphs 13.1(a), 13.1(d), 13.1(e) or 13.1(f) (without any necessity of Lessor to give notice of such default to Lessee), or (iv) Lessor gives to Lessee three or more notices of default under Paragraph 13.1(b), where a late charge becomes payable under Paragraph 13.4 for each such default, or Paragraph 13.1(c), whether or not the defaults are cured.

40. Industrial Park Building. In the event that the Premises are part of a larger building or group of buildings then Lessee agrees that it will abide by, keep and observe all reasonable rules and regulations which Lessor may make and revise from time to time for the management, safety, care, and cleanliness of the building and grounds, the parking of vehicles and the preservation of good order therein as well as for the convenience of other occupants and tenants of the building. The violations of any such rules and regulations shall be deemed a material breach of this Lease by Lessee.

41. Security Measures. Lessee hereby acknowledges that the rental payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of Lessee, its agents and invitees from acts of third parties.

42. Easements. Lessor reserves to itself the right, from time to time, to grant such easements, rights and dedications that Lessor deems necessary or desirable, and to cause the recordation of Parcel Maps and restrictions, so long as such easements, rights, dedications, Maps and restrictions do not unreasonably interfere with the use of the Premises by Lessee. Lessee shall sign any of the aforementioned documents upon

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request of Lessor and failure to do so shall constitute a material breach of this Lease by Lessee without the need for further notice to Lessee.

43. Performance Under Protest. If at any time a dispute shall arise as to any amount or sum of money to be paid by one party to the other under the provisions hereof, the party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment, and there shall survive the right on the part of said party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said party to pay such sum or any part thereof, said party shall be entitled to recover such sum or so much thereof as it was not legally required to pay under the provisions of this Lease.

44. Authority. If Lessee is a corporation, trust, or general or limited partnership, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on behalf of said entity. If Lessee is a corporation, trust or partnership, Lessee shall, within thirty (30) days after execution of this Lease, deliver to Lessor evidence of such authority satisfactory to Lessor.

45. Cashiers Checks.

(a) In the event that any check given to Lessor by Lessee shall not be honored by the bank upon which it is drawn on two or more occasions, then Lessor, at its option may require all future payments to be made by Lessee under this Lease to be made by cashier's checks.

(b) Any payment made by Lessee pursuant to a written notice to pay or be deemed in default under this Lease shall be made by cashier's check.

46. Amendments to Lease.

(a) At such times as a rental adjustment is made to this Lease by virtue of any provision of this Lease, the parties shall execute a written amendment to this Lease to reflect said change.

(b) Lessee agrees to make any non-monetary modifications to this Lease that may be required by an institutional mortgagee of Lessor.

47. Storage Tanks.

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(a) Notwithstanding anything to the contrary in Paragraph 7.5 hereof, Lessee shall not install storage tanks of any size or shape in the Premises, above or below ground, without the consent of the Lessor which can be withheld in Lessor's sole discretion. If Lessor elects to grant its consent, Lessor shall have the right to condition its consent upon Lessee agreeing to give to Lessor such assurances that Lessor, in its sole discretion, deems necessary to protect itself against potential problems concerning the installation, use, removal and contamination of the Premises as a result of the installation and/or use of such tank, including but not limited to the installation of a concrete encasement for said tank. Lessee shall comply at its expense with all applicable permit and/or registration requirements and repair any damage caused by the installation, maintenance or removal of such tank. Upon termination of the Lease, Lessee shall, at its sole cost and expense, remove any tank from the Premises, remove and replace any contaminated soil or materials (and compact or treat the same as then required by law) and repair any damage or change to the Premises caused by said installation and/or removal. Nothing contained herein shall be construed to diminish or reduce Lessee's obligations under Paragraph 48.

(b) Lessor shall have the right to employ experts and/or consultants, at Lessee's expense, to advise Lessor with respect to the installation, operation, monitoring, maintenance and removal and restoration of any such tank.

48. Lessee's Covenants Regarding Hazardous Materials.

48.1 Lessor's Prior Consent. Notwithstanding anything contained in this Lease to the contrary, Lessee has not caused or permitted, and shall not cause or permit any "Hazardous Materials" (as defined in Paragraph 48.2, below) to be brought upon, kept, stored, discharged, released or used in, under or about the Premises by Lessee, its agents, employees, contractors, subcontractors, licensees or invitees, unless (a) such Hazardous Materials are reasonably necessary to Lessee's business and will be handled, used, kept, stored and disposed of in a manner which complies with all "Hazardous Materials Laws" (as defined in Paragraph 48.2, below); (b) Lessee will comply with such other rules or requirements as Lessor may from time to time impose, including without limitation that (i) such materials are in small quantities, properly labeled and contained, (ii) such materials are handled and disposed of in accordance with the highest accepted industry standards for safety, storage, use and disposal, (iii) such materials are for use in the ordinary course of business (i.e., as with office or cleaning supplies), (c) notice of and a copy of the current material safety data sheet is provided to Lessor for each such Hazardous Material, and (d) Lessor shall have granted its prior written consent to the use of such Hazardous Materials.

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48.2 Compliance with Hazardous Materials Laws. As used herein, the term "Hazardous Materials" means any (a) oil, petroleum, petroleum products, flammable substances, explosives, radioactive materials, hazardous wastes or substances, toxic wastes or substances or any other wastes, materials or pollutants which (i) pose a hazard to the Premises or to persons on or about the Premises or (ii) cause the Premises to be in violation of any Hazardous Materials Laws (as hereinafter defined); (b) asbestos in any form, urea formaldehyde foam insulation, transformers or other equipment which contain dielectric fluid containing levels of polychlorinated biphenyls, or radon gas; (c) chemical, material or substance defined as or included in the definition of "hazardous substances," "hazardous wastes," "hazardous materials," "extremely hazardous waste," "restricted hazardous waste," or "toxic substances" or words of similar import under any applicable local, state or federal law or under the regulations adopted or publications promulgated pursuant thereto, including, but not limited to, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C. Section 9601, et seq.; the Resources Conservation Recovery Act, 42 U.S.C. Section 6901, et seq.; the Hazardous Materials Transportation Act, as amended, 49 U.S.C. Section 1801, et seq.; the Federal Water Pollution Control Act as amended, 33 U.S.C. Section 1251, et seq.; Sections 25115, 25117, 25122.7, 25140, 25249.8, 25281, 25316 and 25501 of the California Health and Safety Code; and Article 9 or Article II of Title 22 of the California Code of Regulations, Division 4, Chapter 20; (d) other chemical, material or substance, exposure to which is prohibited, limited or regulated by any governmental authority or may or could pose a hazard to the health and safety of the occupants of the Premises or the owners and/or occupants of property adjacent to or surrounding the Premises, or any other Person coming upon the Premises or adjacent property; and (e) other, chemical, materials or substance which may or could pose a hazard to the environment. As used herein the term "Hazardous Materials Laws" means any federal, state or local laws, ordinances, regulations or policies relating to the environment, health and safety, and Hazardous Materials (including, without limitation, the use, handling, transportation, production, disposal, discharge or storage thereof) or to industrial hygiene or the environmental conditions on, under or about the Premises, including, without limitation, soil, groundwater and indoor and ambient air conditions. Lessee shall at all times and in all respects comply with all Hazardous Materials Laws.

48.3 Materials Removal. Upon expiration or earlier termination of this Lease, Lessee shall at Lessee's sole cost and expense, cause all Hazardous

Materials brought on the Premises with Lessor's consent to be removed from the Premises in compliance with all applicable Hazardous Materials Laws. If Lessee or its employees, agents, or contractors violates the provisions of the foregoing two paragraphs, or if Lessee's acts, negligence, or business operations contaminate, or expand the scope of contamination of, the Premises from such Hazardous Materials,

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then Lessee shall promptly, at Lessee's expense, take all investigatory and/or remedial action (collectively, the "Remediation") that is necessary in order to clean up, remove and dispose of such Hazardous Materials causing the violation on the Premises or the underlying groundwater or the properties adjacent to the Premises to the extent such contamination was caused by Lessee, in compliance with all applicable Hazardous Materials Laws. Lessee shall further repair any damage to the Premises caused by the Hazardous Materials contamination. Lessee shall provide prior written notice to Lessor of such Remediation, and Lessee shall commence such Remediation no later than thirty (30) days after such notice to Lessor and diligently and continuously complete such Remediation. Such written notice shall also include Lessee's method, time and procedure for such Remediation and Lessor shall have the right to require reasonable changes in such method, time or procedure of the Remediation. Lessee shall not take any Remediation in response to the presence of any Hazardous Materials in or about the Premises or enter into any settlement agreement, consent decree or other compromise in respect to any claims relating to any Hazardous Materials in any way connected with the Premises, without first notifying Lessor of Lessee's intention to do so and affording Lessor ample opportunity to appear, intervene or otherwise appropriately assert and protect Lessor's interests with respect thereto.

48.4 Notices. Lessee shall immediately notify Lessor in writing of. (a) any enforcement, cleanup, removal or other governmental or regulatory action threatened, instituted, or completed pursuant to any Hazardous Materials Laws with respect to the Premises; (b) any claim, demand, or complaint made or threatened by any person against Lessee or the Premises relating to damage, contribution, cost recovery compensation, loss or injury resulting from any Hazardous Materials; and (c) any reports made to any governmental authority arising out of any Hazardous Materials on or removed from the Premises. Lessor shall have the right (but not the obligation) to join and participate, as a party, in any legal proceedings or actions affecting the Premises initiated in connection with any Hazardous Materials Laws.

48.5 Indemnification of Lessor. Lessee shall indemnify, protect, defend and forever hold Lessor harmless from any and all damages, losses, expenses, liabilities, obligations and costs arising out of any failure of Lessee to observe the foregoing covenants in Paragraphs 47 and 48. The provisions of Paragraphs 47 and 48 shall survive the expiration or earlier termination of the lease.

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Premises are Reinstated, then this Lease shall terminate effective as of the date the Termination Agreement ceases to be effective.

52. Existing Sublease. As a condition precedent to the effectiveness of this Lease, Lessee shall have caused the termination of all existing subleases in the Premises, without any cost, expense or liability to Lessor and provided Lessor

with reasonable evidence of that termination.

"LESSOR":

THE PRUDENTIAL INSURANCE COMPANY  
OF AMERICA, a New Jersey corporation

By CUSHMAN & WAKEFIELD OF  
CALIFORNIA INC.,  
its Managing Agent

BY /s/ MARK F. HARRYMAN

-----  
Mark F. Harryman, Portfolio Manager

-----  
[Printed Name and Title]

BY /s/ WILLIAM DURSLAG

-----  
William Durslag, Director

-----  
[Printed Name and Title]

"LESSEE":

SKECHERS U.S.A., INC.

By: /s/ DAVID WEINBERG

-----  
David Weinberg, C.F.O.

-----  
[Printed Name and Title]



STANDARD INDUSTRIAL/COMMERCIAL  
SINGLE-TENANT LEASE--NET

1. Basic Provisions ("Basic Provisions")

1.1 PARTIES: This Lease ("LEASE"), dated for reference purposes only, April 10, 1998, is made by and between PROFICIENCY ONTARIO LIMITED PARTNERSHIP, a California limited partnership ("LESSOR") and SKECHERS USA, INC., a California corporation ("LESSEE") (collectively the "PARTIES," or individually a "PARTY").

1.2 PREMISES: That certain real property (the "REAL PROPERTY"), including all improvements therein or to be provided by Lessor under the terms of this Lease, and commonly known by the street address of 5725 East Jurupa Street, City of Ontario, located in the County of San Bernardino, State of California, and generally described as an approximately 285,600 rentable square foot building, as more particularly described on attached Exhibit A and depicted on attached Exhibit B (including the Real Property, the "PREMISES"). (See Paragraph 2 for further provisions.)

1.3 TERM: 7 years ("ORIGINAL TERM") commencing August 1, 1998 ("COMMENCEMENT DATE") and ending July 31, 2005 ("EXPIRATION DATE"). (See Paragraph 3 for further provisions.) Lessee shall have a single option to renew for an additional five (5) years subject to and in accordance with the provisions set forth in Paragraph 50 of the Addendum.

1.4 EARLY POSSESSION: April 10, 1998 ("EARLY POSSESSION DATE"). (See Paragraph 3.2 for further provisions.)

1.5 BASE RENT: For the first 60 months of the Original Term, \$82,824.00 per month ("BASE RENT"), payable on the 1st day of each month commencing August 1, 1998 through and including July 31, 2003. For the next 24 months of the Original Term, the Base Rent shall be increased to \$88,536.00 per month commencing on August 1, 2003, through and including July 31, 2005. (See Paragraph 4 for further provisions.) Base Rent during the Option Period (as defined in the Addendum), if any, shall be determined in accordance with Paragraph 50 of the Addendum.

1.6 BASE RENT PAID UPON EXECUTION: \$82,824.00 as first month's Base Rent to be applied to the period from August 1, 1998 through and including August 31, 1998.

1.7 SECURITY DEPOSIT: \$165,648.00 ("SECURITY DEPOSIT"). (See Paragraph 5 for further provisions.)

1.8 PERMITTED USE: Warehousing, distribution, office and showroom, and uses reasonably related to the foregoing, and no other uses without the prior written consent of Lessor. (See Paragraph 6 for further provisions.)

1.9 INSURING PARTY: Lessor is the "INSURING PARTY" unless otherwise stated herein. (See Paragraph 8 for further provisions.)

1.10 REAL ESTATE BROKERS: The following real estate brokers (collectively, the "BROKERS") and brokerage relationships exist in this transaction and are consented to by the Parties (i) Lessor has been represented exclusively by (A) David Consani of CB Commercial Real Estate Group, Inc., and (B) Kevin McKenna of The Seeley Company (collectively, "LESSOR'S BROKER"); and Lessee has been represented exclusively by (A) Darla Longo and Jeff Morgan of CB Commercial Real Estate Group, Inc., ("LESSEE'S BROKER"). (See Paragraph 15 for further provisions.)

1.11 ADDENDUM. Attached hereto is an Addendum ("ADDENDUM") consisting of Paragraphs 50 through 53, all of which constitute a part of this Lease.

2. PREMISES

2.1 LETTING. Lessor hereby leases to Lessee, and Lessee hereby leases from Lessor, the Premises, for the term, at the rental, and upon all of the terms, covenants and conditions set forth in this Lease. Unless otherwise provided herein, any statement of square footage set forth in this Lease, or that may have been used in calculating rental, is an approximation which Lessor and Lessee agree is reasonable and the rental based thereon is not subject to revision whether or not the actual square footage is more or less.

2.2 CONDITION. Lessor shall deliver the Premises to Lessee clean and free of debris on the Commencement Date or the Early Possession Date, whichever first occurs ("START DATE"), and, so long as all required service contracts described in Paragraph 7.1 (b) below are obtained by Lessee within thirty (30) days following the Start Date, warrants to Lessee that the existing plumbing, fire sprinkler system, lighting, air conditioning, heating, and loading doors, if any, in the Premises, other than those constructed by Lessee, shall be in good operating condition on the Start Date. If a non-compliance with said warranty exists as of the Start Date, Lessor shall, as Lessor's sole obligation with respect to such matter, except as otherwise provided in this Lease, promptly after receipt of written notice from Lessee setting forth with specificity the nature and extent of such noncompliance, rectify same at Lessor's expense. If, after the Start Date, Lessee does not give Lessor written notice of any non-compliance with this warranty within: (i) one year as to the surface of the roof and the structural portions of the roof, foundations and bearing walls, (ii) six (6) months as to the HVAC systems, (iii) six (6) months as to the remaining systems and other elements of the Building, correction of such non-compliance shall be the obligation of Lessee at Lessee's sole cost and expense.

2.3 COMPLIANCE WITH COVENANTS, RESTRICTIONS AND BUILDING CODE. Lessor warrants to Lessee that the improvements on the Premises comply with all applicable covenants or restrictions of record and applicable building, zoning and other use codes, regulations and ordinances in effect on the Commencement Date; provided, however, that if modifications or additional requirements are imposed upon the Premises by any governmental authority as a result of Lessee's specific use of the Premises or its tenant improvement requirements, then in such case Lessee shall be solely responsible for the costs incurred in making such modifications or satisfying such additional requirements. If the Premises do not comply with the foregoing warranty, Lessor shall, except as otherwise provided in this Lease, promptly after receipt of written notice from Lessee setting forth with specificity in the nature and extent of such non-compliance, rectify the same at Lessor's expense. Lessee acknowledges that the Premises are subject to certain covenants, conditions and restrictions ("CC&R's") as more particularly described in paragraph 51 of the Addendum annexed hereto, and Lessee agrees to comply therewith.

### 3. TERM.

3.1 TERM. The Commencement Date, Expiration Date and Original Term of this Lease are as specified in Paragraph 1.3.

3.2 EARLY POSSESSION. Lessee shall be entitled to commence occupancy prior to the Commencement Date provided that such early possession does not in any way interfere with the tenant improvement work required to be done by Lessor in accordance with Paragraph 52 of the Addendum. If Lessee totally or partially occupies the Premises prior to the Commencement Date, the obligation to pay Base Rent shall be abated for the period of such early possession. All other terms of this Lease, however (including without limitation, the obligations under Paragraphs 2.3 (compliance with CC&R's), 6 (use, limitations on activities of Lessee, indemnification and compliance with law) and 7 (maintenance, repairs and alterations), shall be in effect during such period; provided that with respect to the obligations under Paragraphs 8 (insurance) and 10 (the obligations to pay Real Property Taxes), Lessee shall only be obligated to pay one-half of such amounts during said early occupancy period. Any such early possession shall not affect nor advance the Expiration Date of the Original Term

### 4. RENT.

4.1 BASE RENT. Lessee shall cause payment of Base Rent and other rent or charges, as the same may be adjusted from time to time, to be received by Lessor in lawful money of the United States, on or before the day on which it is due under the terms of this Lease. Base Rent and all other rent and charges for any period during the term hereof which is for less than one (1) full calendar month shall be prorated based upon the actual number of days of the calendar

month involved. Payment of Base Rent and other charges

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shall be made to Lessor at its address stated herein or to such other persons or at such other addresses as Lessor may from time to time designate in writing to Lessee.

5. SECURITY DEPOSIT. Lessee shall deposit with Lessor upon execution hereof the Security Deposit set forth in Paragraph 1.7 as security for Lessee's faithful performance of Lessee's obligations under this Lease. If Lessee fails to pay Base Rent or other rent or charges due hereunder, or otherwise Defaults under this Lease (as defined in Paragraph 13.1), Lessor may use, apply or retain all or any portion of said Security Deposit for the payment of any amount due Lessor or to reimburse or compensate Lessor for any liability, cost, expense, loss or damage (including attorneys' fees) which Lessor may suffer or incur by reason thereof. If Lessor uses or applies all or any portion of said Security Deposit, Lessee shall within ten (10) days after written request therefor deposit moneys with Lessor sufficient to restore said Security Deposit to the full amount required by this Lease. Lessor shall not be required to keep all or any part of the Security Deposit separate from its general accounts and no interest shall be payable thereon. Lessor shall, at the expiration or earlier termination of the term hereof and after Lessee has vacated the Premises, return to Lessee (or, at Lessor's option, to the last assignee, if any, of Lessee's interest herein) that portion of the Security Deposit not used or applied by Lessor. Lessor shall keep the Security Deposit in a separate federally insured account bearing interest at market rate, which account (and the funds therein) shall not be commingled with any other funds

6. USE.

6.1 USE. Lessee shall use and occupy the Premises only for the purposes set forth in Paragraph 1.8, or any other use which is comparable thereto, and for no other purpose. Lessee shall not use nor permit the use of the Premises in a manner that creates waste or a nuisance, or that disturbs owners and/or occupants of, or causes damage to, neighboring premises or properties.

6.2 HAZARDOUS SUBSTANCES.

(a) REPORTABLE USES REQUIRE CONSENT. The Term "HAZARDOUS SUBSTANCE" as used in this Lease shall mean any product, substance, chemical, material or waste whose presence, nature, quantity and/or intensity of existence, use, manufacture, disposal, transportation, spill release or effect, either by itself or in combination with other materials expected to be on the Premises, is: (i) potentially injurious to the public health, safety or welfare, the environment or the Premises, (ii) regulated or monitored by any governmental authority, or (iii) a basis for liability of Lessor to any governmental agency or third party under any applicable statute or common law theory. Hazardous Substance shall include, but not be limited to, hydrocarbons, petroleum, gasoline, crude oil or any products, by-products or fractions thereof; provided, however, that Hazardous Substance shall not include any such items used by Lessee in quantities and in a manner which complies with all Applicable Laws, unless such use is a Reportable Use (as hereinafter defined). Lessee shall not engage in any activity in, on or about the Premises which constitutes a Reportable Use of Hazardous Substances without the express prior written consent of Lessor (which consent Lessor may give, withhold or condition in its sole and absolute discretion) and compliance in a timely manner (at Lessee's sole cost and expense) with all Applicable Law (as defined in Paragraph 6.3). "REPORTABLE USE" shall mean (i) the installation or use of any above ground storage tank (it being agreed that in no event shall Lessee install or use any underground storage tanks), (ii) the generation, possession, storage, use, transportation, or disposal of a Hazardous Substance that requires a permit from, or with respect to which a report, notice, registration or business plan is required to be filed with, any governmental authority. Notwithstanding the foregoing, Lessee may, without Lessor's prior consent, but in compliance with all Applicable Law, use any ordinary and customary materials reasonably required to be used by Lessee in the normal course of Lessee's business permitted on the Premises, so long as such use is not a Reportable Use. In addition, Lessor may (but without any obligation to do so) condition its consent to the use or presence of any Hazardous Substance, activity or storage tank by Lessee upon Lessee's giving Lessor such additional assurances as Lessor, in its reasonable discretion, deems

necessary to protect itself, the public, the Premises and the environment against damage, contamination or injury and/or liability therefrom or therefor, including, but not limited to, the installation (and removal on or before Lease expiration or earlier termination) of reasonably necessary protective modifications to the Premises (such as concrete encasements) and/or the deposit of an additional Security Deposit under Paragraph 5 hereof.

(b) DUTY TO INFORM. If Lessee knows, or has reasonable cause to believe, that a Hazardous Substance, or a condition involving or resulting from same, has come to be located in, on, under or about the Premises, other than as previously consented to or caused by Lessor, Lessee shall immediately give written

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notice of such fact to Lessor. Lessee shall also Promptly give Lessor a copy of any statement, report, notice, registration, application, permit, business plan, license, claim, action or proceeding given to, or received from, any governmental authority or private party, or persons entering or occupying the Premises, concerning the presence, spill, release, discharge of, or exposure to, any Hazardous Substance or contamination in, on, or about the Premises, including, but not limited to, all such documents as may be involved in any Reportable Uses involving the Premises. If Lessor knows, or has reasonable cause to believe, that a Hazardous Substance, or a condition involving or resulting in the same, has come to be located in, on, under or about Me Premises, Lessor shall immediately give written notice of such fact to Lessee. All Hazardous Substances in, on, under or about the Premises, and violations of Applicable Laws on or with respect to the Premises on or prior to the Commencement Date, and all matters arising from any such conditions in existence as of the Commencement Date, are referred to herein as "Existing Conditions."

(c) LESSOR'S WARRANTY. Lessor warrants to Lessee that, to Lessor's actual knowledge, the Real Property and the Premises are free from unlawful quantities of Hazardous Substance.

(d) LESSEE INDEMNIFICATION. Lessee shall indemnify, protect, defend and hold Lessor, its agents, employees, lenders and ground lessor, if any, and the Real Property and the Premises, harmless from and against any and all loss of rents and/or losses, damages, liabilities, judgments, costs, claims, liens, expenses, penalties, permits and attorneys' and consultants' fees arising out of or involving any Hazardous Substance or storage tank brought onto the Premises by or for Lessee or under Lessee's control, and any Hazardous Substance introduced into the Real Property or the Premises by a third party during the Term. Lessee's obligations under this Paragraph 6 shall include, but not be limited to, the effects of any contamination or injury to person, property or the environment created or suffered by Lessee, and the cost of investigation (including consultants' and attorneys' fees and testing), removal, remediation, restoration and/or abatement thereof, or any contamination therein involved, and shag survive the expiration or earlier termination of this Lease. No termination, cancellation or release agreement entered into by Lessor and Lessee shall release Lessee from its obligations under this Lease with respect to Hazardous Substances or storage tanks, unless specifically so agreed by Lessor in writing at the time of such agreement.

(e) LESSOR INDEMNIFICATION. Lessor shall indemnify, protect, defend and hold Lessee, its agents, employees and lenders, harmless from and against any and all environmental damages, including the cost of remediation, arising from Existing Conditions or which are caused by the gross negligence or willful misconduct of Lessor, its agents or employees. Lessor's obligations, as and when required by the Applicable Law, shall include, but not be limited to, the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease.

6.3 LESSEE'S COMPLIANCE WITH LAW. Except as otherwise provided in this Lease, Lessee shall, at Lessee's sole cost and expense, fully, diligently and in a timely manner, comply with all "APPLICABLE LAW", which term is used in this Lease to include all laws, rules, regulations, ordinances, directives, covenants, easements and restrictions of record, permits, the requirements of any applicable fire insurance underwriter or rating bureau, and the recommendations of Lessor's engineers and/or consultants, relating in any manner to the Premises (including, but not limited to, matters pertaining to (i)

industrial hygiene, (ii) environmental conditions on, in, under or about the Premises, including soil and groundwater conditions, and (iii) the use, generation, manufacture, production, installation, maintenance, removal, transportation, storage, spill or release of any Hazardous Substance or storage tank), now in effect or which may hereafter come into effect, and whether or not reflecting a change in policy from any previously existing policy; provided, however, that notwithstanding anything to the contrary in the foregoing or elsewhere in this Lease, Lessee shall have no obligation to comply with any Applicable Law, or to take any other action, with respect to Hazardous Substances or the breach of Applicable Law or other matters that pertain to the presence of Hazardous Substances (or a breach of Applicable Law) which are in existence on or with respect to the Premises as of the Commencement Date, or that relate to the Existing Conditions or any of them, or that arise from Hazardous Substance introduced into the Real Property or the Premises during the Term by a third party. Lessee shall, within five (5) days after receipt of Lessor's written request, provide Lessor with copies of all documents and information, including, but not limited to, permits, registrations, manifests, applications, reports and certificates, evidencing Lessee's compliance with any Applicable Law specified by Lessor, and shall immediately upon receipt, notify Lessor in writing (with copies of any documents involved) of any threatened or actual claim, notice, citation, warning, complaint or report Pertaining to or involving failure by Lessee or the Premises to comply with any Applicable Law.

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6.4 INSPECTION; COMPLIANCE. Lessor and Lessor's Lender(s) (as defined in Paragraph 8.3(a)) shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times upon prior reasonable telephonic notice, for the purpose of inspecting the condition of the Premises and for verifying compliance by Lessee with this Lease and all Applicable Laws (as defined in Paragraph 6.3), and to employ experts and/or consultants in connection therewith and/or to advise Lessor with respect to Lessee's activities, including, but not limited to, the installation, operation, use, monitoring, maintenance, or removal of any Hazardous Substance or storage tank on or from the Premises. The costs and expenses of any such inspections shall be paid by the party requesting same, unless a Default or Breach of this Lease, violation of Applicable Law, or a contamination, caused or materially contributed to by Lessee (or which could have been prevented by Lessee by the employment of reasonable security measures), is found to exist or be imminent, or unless the inspection is requested or ordered by a governmental authority as the result of any such existing or imminent violation or contamination. In any such case, Lessee shall upon request reimburse Lessor or Lessor's Lender, as the case may be, for the costs and expenses of such inspections. Notwithstanding anything to the contrary in the foregoing or elsewhere in this Lease, Lessor shall be solely responsible for all Existing Conditions and the consequences thereof. Lessor's access to the Premises shall not unreasonably interfere with Lessee's operations on the Premises.

7. MAINTENANCE; REPAIRS, UTILITY INSTALLATIONS; TRADE FIXTURES AND ALTERATIONS.

7.1 LESSEE'S OBLIGATIONS.

(a) Subject to the provisions of Paragraphs 2.2 (Lessor's warranty as to condition), 2.3 (Lessor's warranty as to compliance with covenants, etc.), and 6.2 (Lessor's responsibility for Existing Conditions), 9 (damage and destruction), and 14 (condemnation), Lessee shall, at Lessee's sole cost and expense and at all times, keep the Premises and every part thereof in good order, condition and repair, structural and non-structural (whether or not such portion of the Premises requiring repair, or the means of repairing the same, are reasonably or readily accessible to Lessee, and whether or not the need for such repairs occurs as a result of Lessee's use, any prior use (except with respect to Existing Conditions), the elements or the age of such portion of the Premises), including, without limiting the generality of the foregoing, all equipment or facilities serving the Premises, such as plumbing, heating, air conditioning, ventilating, electrical, lighting facilities, boilers, fired or unfired pressure vessels, fire sprinkler and/or standpipe and hose or other automatic fire extinguishing system, including fire alarm and/or smoke detection systems and equipment, fire hydrants, fixtures, walls (interior and exterior), foundations, ceilings, roofs, floors, windows, doors, plate glass, skylights, landscaping, driveways, parking lots, fences, retaining walls, signs, sidewalks

and parkways located in, on, about, or adjacent to the Premises. Lessee shall not cause any Hazardous Substance to be spilled or released in, on, under or about the Premises (including through the plumbing or sanitary sewer system) and shall promptly, at Lessee's expense, take all investigatory and/or remedial action formally ordered or required, for the cleanup of any contamination of, and for the maintenance, security and/or monitoring of, the Premises, the elements surrounding same, or neighboring properties, that was caused or materially contributed to by Lessee, or pertaining to or involving any Hazardous Substance and/or storage tank brought onto the Premises by or for Lessee or under its control (except with respect to Existing Conditions). Lessee, in keeping the Premises in good order, condition and repair, shall exercise and perform good maintenance practices.

(b) Lessee shall purchase and keep in effect at all times during the Term maintenance contracts with reputable maintenance contractors satisfactory to Lessor covering the heating, air conditioning and ventilating systems (including boilers, fired or unfired pressure vessels), and the roof.

(c) Lessee shall be required to repaint the exterior of the building every five (5) years, with the first repainting to be completed prior to the fifth anniversary of the Commencement Date. Lessor shall approve the painting contractor and the grade and color of the paint. In no event shall Lessee be entitled to alter the color of the exterior of the building without the prior approval of Lessor.

7.2 WAIVER OF STATUTORY BENEFITS. It is the intention of the Parties that the terms of this Lease govern the respective obligations of the Parties as to maintenance and repair of the Premises. Lessee and Lessor expressly waive the benefit of any statute now or hereafter in effect to the extent it is inconsistent with the terms of this Lease with respect to, or which affords Lessee the right to make repairs at the expense of Lessor or to terminate this Lease by reason of, any needed repairs.

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### 7.3 UTILITY INSTALLATIONS; TRADE FIXTURES; ALTERATIONS.

(a) DEFINITIONS, CONSENT REQUIRED. The term "UTILITY INSTALLATIONS" is used in this Lease to refer to all carpeting, window coverings, air lines, power panels, electrical distribution, security, fire protection systems, communication systems, lighting fixtures, heating, ventilating, and air conditioning equipment, plumbing, and fencing in, on or about the Premises. The term "TRADE FIXTURES" shall mean Lessee's machinery and equipment that can be removed without doing material damage to Premises. The term "ALTERATIONS" shall mean any modification of the improvements on the Premises from that which are provided by Lessor under the terms of this Lease, other than Utility Installations or Trade Fixtures, whether by addition or deletion. "LESSEE OWNED ALTERATIONS AND/OR UTILITY INSTALLATIONS" are defined as Alterations and/or Utility Installations made by Lessee that are not yet owned by Lessor as defined in Paragraph 7.4(a). Lessee shall not make any Alterations or Utility Installations in, on, under or about the Premises without Lessor's prior written consent. Lessee may, however, make non-structural Utility Installations to the interior of the Premises (excluding the roof), as long as they are not visible from the outside, do not involve puncturing, relocating or removing the roof or any existing walls.

(b) CONSENT. Any Alterations or Utility Installations that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written form with proposed detailed plans. All consents given by Lessor, whether by virtue of Paragraph 7.3(a) or by subsequent specific consent, shall be deemed conditioned upon: (i) Lessee's acquiring all applicable permits required by governmental authorities, (ii) the furnishing of copies of such permits together with a copy of the plans and specifications for the Alteration or Utility Installation to Lessor prior to the commencement of the work thereon, and (iii) the compliance by Lessee with all conditions of said permits in a prompt and expeditious manner. Any Alterations or Utility Installations by Lessee during the term of this Lease shall be done in a good and workmanlike manner, with good and sufficient materials, and in compliance with all Applicable Law. Lessee shall promptly upon completion thereof furnish Lessor with as-built plans and specifications therefor. For work which costs an amount in excess of \$25,000, Lessor may condition its consent upon Lessee

providing a lien and completion bond in an amount equal to one and one-half times the estimated cost of such Alteration or Utility Installation and/or upon Lessee's posting an additional Security Deposit with Lessor.

(c) INDEMNIFICATION. Lessee shall pay, when due, all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use on the Premises, which claims are or may be secured by any mechanics' or materialmen's lien against the Premises or any interest therein. Lessee shall give Lessor not less than ten (10) days' notice prior to the commencement of any work in, on or about the Premises, and Lessor shall have the right to post notices of non-responsibility in, on or about the Premises as provided by law. If Lessee shall, in good faith, contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense defend and protect itself, Lessor and the Premises against the same and shall pay and satisfy any such adverse judgment that may be rendered thereon before the enforcement thereof against the Lessor or the Premises. If Lessor shall require, Lessee shall post a surety bond in an amount equal to the lesser of one-and-one-half times the amount of such contested lien claim or demand, or the amount required by law to discharge the lien. In addition, Lessee shall pay Lessor's attorneys' fees and costs if Lessor elects to participate in any such action.

#### 7.4 OWNERSHIP; REMOVAL; SURRENDER; AND RESTORATION.

(a) OWNERSHIP. Subject to Lessor's right to require their removal or become the owner thereof as hereinafter provided in this Paragraph 7.4, all Alterations and Utility Additions made to the Premises by Lessee shall be the property of and owned by Lessee, but considered a part of the Premises. Lessor may, at any time and at its option, elect in writing to Lessee to be the owner of all or any specified part of the Lessee Owned Alterations, provided that such election must be made prior to the time Lessee commences work on such improvements.

(b) REMOVAL. Unless otherwise agreed in writing, Lessor may require that any or all Lessee Owned Alterations or Utility Installations be removed by the expiration or earlier termination of this Lease, notwithstanding their installation may have been consented to by Lessor, provided that such election must be made prior to the time Lessee commences work on such improvements. Lessor may require the removal at any time of all or any part of any Lessee Owned Alterations or Utility installations made without the required consent of Lessor.

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(c) SURRENDER/RESTORATION. Lessee shall surrender the Premises by the end of the last day of the Lease term or any earlier termination date, with all of the improvements, parts and surfaces thereof clean and free of debris and in good operating order, condition and state of repair, ordinary wear and tear excepted. "ORDINARY WEAR AND TEAR" shall not include any damage or deterioration that would have been prevented by good maintenance practice or by Lessee performing all of its obligations under this Lease. Except as otherwise agreed or specified in writing by Lessor, the Premises, as surrendered, shall include the Utility Installations. The obligation of Lessee shall include the repair of any damage occasioned by the installation, maintenance or removal of Lessee's Trade Fixtures, furnishings, equipment, and Alterations and/or Utility Installations, as well as the removal of any storage tank installed by or for Lessee, and the removal, replacement, or remediation of any soil, material or ground water contaminated by Lessee, all as may then be required by Applicable Law and/or good practice. Lessee's Trade Fixtures shall remain the property of Lessee and shall be removed by Lessee subject to its obligation to repair and restore the Premises per this Lease.

(d) LESSOR'S WAIVER. Notwithstanding anything to the contrary set forth in this Paragraph 7.4 or any other provision of this Lease, any and all property used by Lessee in the operation of its business, whether or not such property constitutes Lessee's trade fixtures, shall be and shall remain the property of Lessee, may be encumbered by Lessee, and, at Lessee's option, may be removed by Lessee (or its designees) upon, or within thirty days after, the expiration of the term of this Lease. Without limiting the generality of the foregoing, Lessor agrees to execute any "landlord's waiver" which may be requested by any lender of Lessee, in which Lessor shall, without limiting the

generality of the foregoing, waive its rights with respect to such property, and shall grant such rights to Lessee's lender as Lessee's lender may reasonably require with respect to the maintenance and removal of such property.

## 8. INSURANCE; INDEMNITY.

8.1 PAYMENT FOR INSURANCE. Regardless of whether the Lessor or Lessee is the Insuring Party, Lessee shall pay for all insurance required under this Paragraph 8 except to the extent of the cost attributable to liability insurance carried by Lessor in excess of \$1,000,000 per occurrence. All such insurance policies shall be maintained with reputable insurance companies licensed to transact business in the State of California and at commercially reasonable rates. Premiums for policy periods commencing prior to or extending beyond the Lease term shall be prorated to correspond to the Lease term. Payment shall be made by Lessee to Lessor within ten (10) days following receipt of an invoice for any amount due.

### 8.2 LIABILITY INSURANCE.

(a) CARRIED BY LESSEE. Lessee shall obtain and keep in force during the term of this Lease a Commercial General Liability policy of insurance protecting Lessee and Lessor (as an additional insured) against claims for bodily injury, personal injury and property damage based upon, involving or arising out of the ownership, use, occupancy or maintenance of the Premises and all areas appurtenant thereto. Such insurance shall be on an occurrence basis providing single limit coverage in an amount not less than \$1,000,000 per occurrence with an "Additional Insured-Managers or Lessors of Premises" Endorsement and contain the "Amendment of the Pollution Exclusion" for damage caused by heat, smoke or fumes from a hostile fire. The policy shall not contain any intra-insured exclusions as between insured persons or organizations, but shall include coverage for liability assumed under this Lease as an "insured contract" for the performance of Lessee's indemnity obligations under this Lease. The limits of said insurance required by this Lease or as carried by Lessee shall not, however, limit the liability of Lessee nor relieve Lessee of any obligation hereunder. All insurance to be carried by Lessee shall be primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only. In addition, Lessee shall be responsible for the costs of maintaining flood insurance on the portion of the improvements located within a 100-year flood plain.

(b) CARRIED BY LESSOR. In the event Lessor is the Insuring Party, Lessor shall also maintain liability insurance described in Paragraph 8.2(a) above, in addition to, and not in lieu of, the insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein.

### 8.3 PROPERTY INSURANCE - BUILDING, IMPROVEMENTS AND RENTAL VALUE.

(a) BUILDING AND IMPROVEMENTS. The Insuring Party shall obtain and keep in force during the term of this Lease a policy or policies in the name of Lessor, with loss payable to Lessor and to the holders of

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any mortgages, deeds of trust or ground leases on the Premises ("LENDER(S)"), insuring loss or damage to the Premises. The amount of such insurance shall be equal to the full replacement cost of the Premises, as the same shall exist from time to time, or the amount required by Lenders, but in no event more than the commercially reasonable and available insurable value thereof if, by reason of the unique nature or age of the improvements involved, such latter amount is less than full replacement cost. If Lessor is the Insuring Party, however, Lessee Owned Alterations and Utility Installations shall be insured by Lessee under Paragraph 8.4 rather than by Lessor. If the coverage is available and commercially appropriate, such policy or policies shall insure against all risks of direct physical loss or damage (except the perils of flood and/or earthquake unless required by a Lender), including coverage for any additional costs resulting from debris removal and reasonable amounts of coverage for the enforcement of any ordinance or law regulating the reconstruction or replacement of any undamaged sections of the Premises required to be demolished or removed by reason of the enforcement of any building, zoning, safety or land use laws as the result of a covered cause of loss. Said policy or policies shall also



contain an agreed valuation provision in lieu of any coinsurance clause, waiver or subrogation, and inflation guard protection causing an increase in the annual property insurance coverage amount by a factor of not less than the adjusted U.S. Department of Labor Consumer Price Index for All Urban Consumers for the city nearest to where the Premises are located. If such insurance coverage has a deductible clause, the deductible amount shall not exceed \$10,000 per occurrence, and Lessee shall be liable for such deductible amount in the event of an Insured Loss, as defined in Paragraph 9.1(c); provided, however, that the deductible amounts for flood and/or earthquake insurance (if required by a Lender) shall be in such amounts as are reasonably required by a Lender.

(b) RENTAL VALUE. The Insuring Party shall, in addition, obtain and keep in force during the term of this Lease a policy or policies in the name of Lessor, with loss payable to Lessor and Lender(s), insuring the loss of the full rental and other charges payable by Lessee to Lessor under this Lease for one (1) year (including all real estate taxes, insurance costs, and any scheduled rental increases). Said insurance shall provide that in the event the Lease is terminated by reason of an insured loss, the period of indemnity for such coverage shall be extended beyond the date of the completion of repairs or replacement of the Premises, to provide for one full year's loss of rental revenues from the date of any such loss. Said insurance shall contain an agreed valuation provision in lieu of any coinsurance cause, and the amount of coverage shall be adjusted annually to reflect the projected rental income, property taxes, insurance premium costs and other expenses, if any, otherwise payable by Lessee, for the next twelve (12) month period. Lessee shall be liable for any deductible amount in the event of such loss.

(c) TENANT'S IMPROVEMENTS. If the Lessor is the Insuring Party, the Lessor shall not be required to insure Lessee Owned Alterations and Utility Installations unless the item in question has become the property of Lessor under the terms of this Lease. If Lessee is the Insuring Party, the policy carried by Lessee under this Paragraph 8.3 shall insure Lessee Owned Alterations and Utility Installations.

8.4 LESSEE'S PROPERTY INSURANCE. Subject to the requirements of Paragraph 8.5, Lessee at its cost shall either by separate policy or, at Lessor's option, by endorsement to a policy already carried, maintain insurance coverage on all of Lessee's personal property, Lessee Owned Alterations and Utility Installations in, on, or about the Premises similar in coverage to that carried by the Insuring Party under Paragraph 8.3. Such insurance shall be full replacement cost coverage with a deductible of not to exceed \$1,000 per occurrence. The proceeds from any such insurance shall be used by Lessee for the replacement of personal property or the restoration of Lessee Owned Alterations and Utility Installations. Lessee shall be the Insuring Party with respect to the insurance required by this Paragraph 8.4 and shall provide Lessor with written evidence that such insurance is in force.

8.5 INSURANCE POLICIES. Insurance required hereunder shall be with companies duly licensed to transact business in the state where the Premises are located, and maintaining during the policy term a 'General Policyholders Rating' of at least B+, V, or such other rating as may be required by a Lender having a lien on the Premises, as set forth in the most current issue of "Best's insurance Guide." Lessee shall not do or permit to be done anything which shall invalidate the insurance policies referred to in this Paragraph 8. If Lessee is the Insuring Party, Lessee shall cause to be delivered to Lessor certified copies of policies of such insurance or certificates evidencing the existence and amounts of such insurance with the insured and loss payable clauses as required by this lease. No such policy shall be cancelable or subject to modification except after thirty (30) days' prior written notice to Lessor. Lessee shall at least thirty (30) days prior to the expiration of such policies, furnish Lessor with evidence of renewals or "insurance binders" evidencing renewal thereof, or Lessor may order such insurance and charge the cost thereof to Lessee, which amount

shall be payable by Lessee to Lessor upon demand. If the Insuring Party shall fail to procure and maintain the insurance required to be carried by the Insuring Party under this Paragraph 8, the other Party may, but shall not be required to, procure and maintain the same, but at Lessee's expense.

8.6 WAIVER OF SUBROGATION. Without affecting any other rights or remedies, Lessee and Lessor ("Waiving Party") each hereby release and relieve the other, and waive their entire right to recover damages (whether in contract or in tort) against the other, for loss of or damage to the Waiving Party's property arising out of or incident to the perils required to be insured against under Paragraph 8. The effect of such releases and waivers of the right to recover damages shall not be limited by the amount of insurance carried to required, or by any deductibles applicable thereto.

9. DAMAGE OR DESTRUCTION.

9.1 DEFINITIONS.

(a) "PREMISES PARTIAL DAMAGE" shall mean damage or destruction to the improvements on the Premises, other than Lessee Owned Alterations and Utility Installations, the repair cost of which damage or destruction is less than 90% of the then Replacement Cost of the Premises immediately prior to such damage or destruction, excluding from such calculation the value of the land and Lessee Owned Alterations and Utility Installations.

(b) "PREMISES TOTAL DESTRUCTION" shall mean damage or destruction to the Premises, other than Lessee Owned Alterations and Utility Installations, the repair cost of which damage or destruction is 90% or more of the then Replacement Cost of the Premises immediately prior to such damage or destruction, excluding from such calculation the value of the land and Lessee Owned Alterations and Utility Installations.

(c) "INSURED LOSS" shall mean damage or destruction to improvements on the Premises, other than Lessee Owned Alterations and Utility Installations, which was caused by an event required to be covered by the insurance described in Paragraph 8.3(a), irrespective of any deductible amounts or coverage limits involved.

(d) "REPLACEMENT COST" shall mean the cost to repair or rebuild the improvements owned by Lessor at the time of the occurrence to their condition existing immediately prior thereto, including demolition, debris removal and upgrading required by the operation of applicable building codes, ordinances or laws, and without deduction for depreciation.

9.2 PARTIAL DAMAGE - INSURED LOSS. If a Premises Partial Damage that is an insured Loss occurs, then Lessor shall, at Lessor's expense, repair such damage (but not Lessee's Trade Fixtures or Lessee Owned Alterations and Utility Installations) as soon as reasonably possible and this Lease shall continue in full force and effect; provided, however, that if Lessee reasonably determines that the Premises cannot be completely restored within six (6) months of the occurrence of the Premises Partial Damage, or if such damage is not actually repaired within such time frame, then Lessee may, by providing Lessor with written notice, terminate this Lease and its remaining obligations hereunder. Notwithstanding the foregoing, if the required insurance was not in force or the insurance proceeds are not sufficient to effect such repair, Lessee shall promptly contribute the shortage in proceeds as and when required to complete said repairs. Lessor shall complete the repairs as soon as reasonably possible and this Lease shall remain in full force and effect. Premises Partial Damage due to flood or earthquake shall be subject to Paragraph 9.3 rather than Paragraph 9.2, notwithstanding that there may be some insurance coverage, but the net proceeds of any such insurance shall be made available for the repairs if made by either Party.

9.3 PARTIAL DAMAGE - UNINSURED LOSS. If a Premises Partial Damage that is not an Insured Loss occurs, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessee's expense and this Lease shall continue in full force and effect, but subject to Lessor's rights under Paragraph 13), Lessor may at Lessor's option, either: (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect; provided, however, that if Lessee reasonably determines that the Premises cannot be completely restored within six (6) months of the occurrence of the Premises Partial Damage, or if such damage is not actually repaired within such time frame, then Lessee may, by providing Lessor with written notice, terminate this Lease and its remaining obligations hereunder; or (ii) give written notice to Lessee within five (5) days after receipt by Lessor of knowledge of the

occurrence of such damage of Lessor's desire to terminate this Lease as of the date sixty (60) days following the giving of such notice. In the event Lessor elects to give such notice of Lessor's intention to terminate this Lease, Lessee shall have the right within ten (10) days after the receipt of such notice to give written notice to Lessor of Lessee's commitment to pay for the repair of such damage totally at Lessee's expense and without reimbursement from Lessor. Lessee shall provide Lessor with the required funds or satisfactory assurance thereof within thirty (30) days following such commitment. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such repairs as soon as reasonably possible and the required funds are available. If Lessee does not give such notice and provide the funds or assurance thereof within the times specified above, this Lease shall terminate as of the date specified in Lessor's notice of termination.

9.4 TOTAL DESTRUCTION. Notwithstanding any other provision hereof, if a Premises Total Destruction occurs (including any destruction required by any authorized public authority), this Lease shall terminate sixty (60) days following the date of such Premises Total Destruction, whether or not the damage or destruction is an Insured Loss or was caused by a negligent or willful act of Lessee. In the event, however, that the damage or destruction was caused by Lessee, Lessor shall have the right to recover Lessor's damages from Lessee except as released and waived in Paragraph 8.6.

9.5 DAMAGE NEAR END OF TERM. If at any time during the last six (6) months of the term of this Lease there is damage for which the cost to repair exceeds one (1) month's Base Rent, whether or not an Insured Loss, Lessor may, at Lessor's option, terminate this Lease effective sixty (60) days following the date of occurrence of such damage by giving written notice to Lessee of Lessor's election to do so within five (5) days after the date of occurrence of such damage; provided, however, if Lessee at that time has an exercisable option to extend this Lease or to purchase the Premises, then Lessee may preserve this Lease by, within twenty (20) days following the occurrence of the damage or before the expiration of the time provided in such option for its exercise, whichever is earlier ("EXERCISE PERIOD"), (i) exercising such option and (ii) if such damage results from an Uninsured Loss, providing Lessor with any shortage in insurance proceeds (or adequate assurance thereof) needed to make the repairs. If Lessee duly exercises such option during said Exercise Period and provides Lessor with funds (or adequate assurance thereof) to cover any shortage in insurance proceeds, if such damage results from an Uninsured Loss, Lessor shall, at Lessor's expense repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect. If Lessee fails to exercise such option and provide such funds or assurance during said Exercise Period, then Lessor may at Lessor's option terminate this Lease as of the expiration of said sixty (60) day period following the occurrence of such damage by giving written notice to Lessee of Lessor's election to do so within ten (10) days after the expiration of the Exercise Period, notwithstanding any term or provision in the grant to the contrary.

#### 9.6 ABATEMENT OF RENT; LESSEE'S REMEDIES.

(a) In the event of damage described in Paragraphs 9.2, 9.3 or 9.4, whether or not Lessor or Lessee repairs or restores the Premises, the Base Rent, Real Property Taxes, insurance premiums, and other charges, if any, payable by Lessee hereunder for the period during which such damage, its repair or the restoration continues shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired. Except for abatement of Base Rent, Real Property Taxes, insurance premiums, and other charges, if any, as aforesaid, all other obligations of Lessee hereunder shall be performed by Lessee, and Lessee shall have no claim against Lessor for any damage suffered by reason of any such repair or restoration.

(b) If Lessor shall be obligated to repair or restore the Premises under the provisions of this Paragraph 9 and shall not commence, in a substantial and meaningful way, the repair or restoration of the Premises within thirty (30) days after such obligation shall accrue, Lessee may, at any time prior to the commencement of such repair or restoration, give written notice to Lessor and to any Lenders of which Lessee has actual notice of Lessee's election to terminate this Lease on a date not less than sixty (60) days following the giving of such notice. If Lessee give such notice to Lessor and such Lenders and such repair or restoration is not commenced within twenty (20) days after

receipt of such notice, this Lease shall terminate as of the date specified in said notice. If Lessor or a Lender commences the repair or restoration of the Premises within ten (10) days after receipt of such notice, this Lease shall continue in full force and effect. "COMMENCE" as used in this Paragraph shall mean either the unconditional authorization of the preparation of the required plans or the beginning of the actual work on the Premises, whichever first occurs.

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9.7 TERMINATION - ADVANCE PAYMENTS. Upon termination of this Lease pursuant to this Paragraph 9, an equitable adjustment shall be made concerning advance Base Rent and any other advance payments made by Lessee to Lessor. Lessor shall, in addition, return to Lessee so much of Lessee's Security Deposit as has not been, or is not then required to be, used by Lessor under the terms of this Lease.

9.8 WAIVE STATUTES. Lessor and Lessee agree that the terms of this Lease shall govern the effect of any damage to or destruction of the Premises with respect to the termination of this Lease and hereby waive the provisions of any present or future statute to the extent inconsistent herewith.

10. REAL PROPERTY TAXES.

10.1 PAYMENT OF TAXES. Lessee shall pay the Real Property Taxes, as defined in Paragraph 10.2 applicable to the Premises during the term of this Lease. All such payments shall be made on or prior to the delinquency date of the applicable installment. Lessee shall promptly furnish Lessor with satisfactory evidence that such taxes have been paid. If any such taxes to be paid by Lessee shall cover any period of time prior to or after the expiration or earlier termination of the term hereof, Lessee's share of such taxes shall be equitably prorated to cover only the period of time within the tax fiscal year this Lease is in effect, and Lessor shall reimburse Lessee for any overpayment after such proration. If Lessee shall fail to pay any Real Property Taxes required by this Lease to be paid by Lessee, Lessor shall have the right to pay the same, and Lessee shall reimburse Lessor therefor upon demand.

10.2 DEFINITION OF "REAL PROPERTY TAXES." As used herein, the term "REAL PROPERTY TAXES" shall include any form of real estate tax or assessment, general, special, ordinary or extraordinary, and any license fee, commercial rental tax, improvement bond or bonds, levy or tax (other than inheritance, personal income or estate taxes) imposed upon the Premises by any authority having the direct or indirect power to tax, including any city, state or federal government, or any school, agricultural, sanitary, fire, street, drainage or other improvement district thereof, levied against any legal or equitable interest of Lessor in the Premises or in the real property of which the Premises are a part, Lessor's right to rent or other income therefrom, and/or Lessor's business of leasing the Premises.

10.3 JOINT ASSESSMENT. If the Premises are not separately assessed, Lessee's liability shall be an equitable proportion of the Real Property Taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available. Lessor's reasonable determination thereof, in good faith, shall be conclusive.

10.4 PERSONAL PROPERTY TAXES. Lessee shall pay prior to delinquency all taxes assessed against and levied upon Lessee Owned Alterations, Utility Installations, Trade Fixtures, furnishings, equipment and all personal property of Lessee contained in the Premises or elsewhere. When possible, Lessee shall cause its Trade Fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor. If any of Lessee's said personal property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee within ten (10) days after receipt of a written statement setting forth the taxes applicable to Lessee's property or, at Lessor's option, as provided in Paragraph 10.1(b).

11. UTILITIES. Lessee shall pay for all water, gas, heat, light, power, telephone, trash disposal and other utilities and services supplied to the Premises, together with any taxes thereon. If any such services are not

separately metered to Lessee, Lessee shall pay a reasonable portion, to be determined by Lessor, of all charges jointly metered with other premises.

## 12. ASSIGNMENT AND SUBLETTING.

### 12.1 LESSOR'S CONSENT REQUIRED.

(a) Lessee shall not voluntarily or by operation of law assign, transfer, mortgage or otherwise transfer or encumber (collectively, "ASSIGNMENT") all or any part of Lessee's interest in this Lease or in the Premises without Lessor's prior written consent given under and subject to the terms of Paragraph 36; provided, however, that Lessor agrees not to unreasonably withhold its consent to a sublease of all or a

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portion of the Premises if and so long as the proposed sublessee has a net worth equal to or greater than (i) the Net Worth of Lessee at the time of the execution of this Lease or (ii) the Net Worth of Lessee at the time of the proposed sublease, whichever is greater. "NET WORTH OF LESSEE" (and the net worth of any proposed sublessee) shall mean the net worth of Lessee (excluding any guarantors) established under generally accepted accounting principles.

(b) An assignment of Lessee's interest in this Lease without Lessor's specific prior written consent shall, at Lessor's option, be a Default curable after notice per Paragraph 13.1(c), or a noncurable Breach without the necessity of any notice and grace period. If Lessor elects to treat such unconsented-to assignment or subletting as a noncurable Breach, Lessor shall have the right to either: (i) terminate this Lease, or (ii) upon thirty (30) days' written notice ("LESSOR'S NOTICE"), increase the monthly Base Rent to fair market rental value or one hundred ten percent (110%) of the Base Rent then in effect, whichever is greater. Pending determination of the new fair market rental value, if disputed by Lessee, Lessee shall pay the amount set forth in Lessor's Notice, with any overpayment credited against the next installments) of Base Rent coming due, and any underpayment for the period retroactively to the effective date of the adjustment being due and payable immediately upon the determination thereof. Further, in the event of such Breach and market value adjustment, (i) the purchase price of any option to purchase the Premises held by Lessee shall be subject to similar adjustment to the then fair market value (without the Lease being considered an encumbrance or any deduction for depreciation or obsolescence, and considering the Premises at its highest and best use and in good condition), or one hundred ten percent (110%) of the price previously in effect, whichever is greater, (ii) any index-oriented rental or price adjustment formulas contained in this Lease shall be adjusted to require that the base index be determined with reference to the index applicable to the time of such adjustment, and (iii) any fixed rental adjustments scheduled during the remainder of the Lease term shall be increased in the same ratio as the new market rental value bears to the Base Rent in effect immediately prior to the market value adjustment.

### 12.2 TERM AND CONDITIONS APPLICABLE TO ASSIGNMENT AND SUBLETTING.

(a) Regardless of Lessor's consent, any assignment or subletting shall not: (i) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (ii) release Lessee of any obligations hereunder, or (iii) alter the primary liability of Lessee for the payment of Base Rent and other sums due Lessor hereunder or for the performance of any other obligations to be performed by Lessee under this Lease.

(b) Lessor may accept any rent or performance of Lessee's obligations from any person other than Lessee pending approval or disapproval of an assignment. Neither a delay in the approval or disapproval of such assignment nor the acceptance of any rent or performance shall constitute a waiver or estoppel of Lessor's right to exercise its remedies for the Default or Breach by Lessee of any of the terms, covenants or conditions of this Lease.

(c) The consent of Lessor to any assignment or subletting shall not constitute a consent to any subsequent assignment or subletting by Lessee or to any subsequent or successive assignment or subletting by the sublessee. However, Lessor may consent to subsequent sublettings and assignments of the

sublease or any amendments or modifications thereto without notifying Lessee or anyone else liable on the Lease or sublease and without obtaining their consent, and such action shall not relieve such persons from liability under this Lease or sublease.

(d) In the event of any Default or Breach of Lessee's obligations under this Lease, Lessor may proceed directly against Lessee, any Guarantors or anyone else responsible for the performance of the Lessee's obligations under this Lease, including the sublessee, without first exhausting Lessor's remedies against any other person or entity responsible therefor to Lessor, or any security held by Lessor or Lessee.

(e) Each request for consent to an assignment or subletting shall be in writing, accompanied by information relevant to Lessor's determination as to the financial and operational responsibility and appropriateness of the proposed assignee or sublessee, including, but not limited to, the intended use and/or required modification of the Premises, if any, together with a non-refundable deposit of \$1,000 as reasonable consideration for Lessor's considering and processing the request for consent. Lessee agrees to provide Lessor with such other or additional information and/or documentation as may be reasonably requested by Lessor.

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(f) Any assignee of, or sublessee under, this Lease shall, by reason of accepting such assignment or entering into such sublease, be deemed, for the benefit of Lessor, to have assumed and agreed to conform and comply with each and every term, covenant, condition and obligation herein to be observed or performed by Lessee during the term of said assignment or sublease, other than such obligations as are contrary to or inconsistent with provisions of an assignment or sublease to which Lessor has specifically consented in writing.

12.3 ADDITIONAL TERMS AND CONDITIONS APPLICABLE TO SUBLETTING. The following terms and conditions shall apply to any subletting by Lessee of all or any part of the Premises and shall be deemed included in all subleases under this Lease whether or not expressly incorporated therein:

(a) Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all rentals and income arising from any sublease of all or a portion of the Premises heretofore or hereafter made by Lessee, and Lessor may collect such rent and income and apply same toward Lessee's obligations under this Lease; provided, however, that until a Breach (as defined in Paragraph 13.1) shall occur in the performance of Lessee's obligations under this Lease, Lessee may, except as otherwise provided in this Lease, receive, collect and enjoy the rents accruing under such sublease. Lessor shall not, by reason of this or any other assignment of such sublease to Lessor, nor by reason of the collection of the rents from a sublessee, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee under such sublease. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice from Lessor stating that a Breach exists in the performance of Lessee's obligations under this Lease, to pay to Lessor the rents and other charges due and to become due under the sublease. Sublessee shall rely upon any such statement and request from Lessor and shall pay such rents and other charges to Lessor without any obligation or right to inquire as to whether such Breach exists and notwithstanding any notice from or claim from Lessee to the contrary. Lessee shall have no right or claim against said sublessee, or, until the Breach has been cured, against Lessor, for any such rents and other charges so paid by said sublessee to Lessor.

(b) In the event of a Breach by Lessee in the performance of its obligations under this Lease, Lessor, at its option and without any obligation to do so, may require any sublessee to attorn to Lessor, in which event Lessor shall undertake the obligations of the sublessor under such sublease from the time of the exercise of said option to the expiration of such sublease; provided, however, Lessor shall not be liable for any prepaid rents or security deposit paid by such sublessee to such sublessor or for any other prior Defaults or Breaches of such sublessor under such sublease.

(c) Any matter or thing requiring the consent of the sublessor under a sublease shall also require the consent of Lessor herein.

(d) No sublessee shall further assign or sublet all or any part of the Premises without Lessor's prior written consent.

(e) Lessor shall deliver a copy of any notice of Default or Breach by Lessee to the sublessee, who shall have the right to cure the Default of Lessee within the grace period, if any, specified in such notice. The sublessee shall have a right of reimbursement and offset from and against Lessee for any such Defaults cured by the sublessee.

12.4 Notwithstanding anything to the contrary in the foregoing, Lessee may (a) sublease all or any portion of the Premises to any person or entity, (b) assign its interest in this Lease and the Premises to any person or entity which purchases all or substantially all of Lessee's assets, in either case without Lessor's consent or approval.

### 13. DEFAULT; BREACH; REMEDIES.

13.1 DEFAULT; BREACH. Lessor and Lessee agree that if an attorney is consulted by Lessor in connection with a Lessee Default or Breach (as hereinafter defined), \$350.00 is a reasonable sum per such occurrence for legal services and costs in the preparation and service of a notice of Default, and that Lessor may include the cost of such services and costs in said notice as rent due and payable to cure said Default. A "DEFAULT" is defined as a failure by the Lessee to observe, comply with or perform any of the terms, covenants, conditions or rules applicable to Lessee under this Lease. A "BREACH" is defined as the occurrence

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of any one or more of the following Defaults, and, where a grace period for cure after notice is specified herein, the failure by Lessee to cure such Default prior to the expiration of the applicable grace period, and shall entitle Lessor to pursue the remedies set forth in Paragraphs 13.2 and/or 13.3:

(a) The vacating of the Premises without the intention to reoccupy same, or the abandonment of the Premises for more than ninety (90) consecutive days.

(b) Except as expressly otherwise provided in this Lease, the failure by Lessee to make any payment of Base Rent or any other monetary payment required to be made by Lessee hereunder, whether to Lessor or to a third party, as and when due, the failure by Lessee to provide Lessor with reasonable evidence of insurance or surety bond required under this Lease, or the failure of Lessee to fulfill any obligation under this Lease which endangers or threatens life or property, where such failure continues for a period of ten (10) days following written notice thereof by or on behalf of Lessor to Lessee.

(c) Except as expressly otherwise provided in this Lease, the failure by Lessee to provide Lessor with reasonable written evidence (in duly executed original form, if applicable) of (i) compliance with Applicable Law per Paragraph 6.3, (ii) the recession of an unauthorized assignment or subletting per Paragraph 12.1 (b), (iii) a Tenancy Statement per Paragraphs 16 or 37, (iv) the subordination or non-subordination of this Lease per Paragraph 30, (v) the guaranty of the performance of Lessee's obligations under this Lease if required under Paragraphs 1.11 and 37, (vi) the execution of any document requested under Paragraph 42 (easements), or (vii) any other documentation or information which Lessor may reasonably require of Lessee under the terms of this Lease, where any such failure continues for a period of ten (10) days following written notice by or on behalf of Lessor to Lessee.

(d) A Default by Lessee as to the terms, covenants, conditions or provisions of this Lease, or of the rules adopted under Paragraph 40 hereof, that are to be observed, complied with or performed by Lessee, other than those described in subparagraphs (a), (b) or (c), above, where such Default continues for a period of thirty (30) days after written notice thereof by or on behalf of Lessor to Lessee; provided, however, that if the nature of Lessee's Default is such that more than thirty (30) days are reasonably required for its cure, then it shall not be deemed to be a Breach of this Lease by Lessee if Lessee commences such cure within said thirty (30) day period and thereafter diligently prosecutes such cure to completion.

(e) The occurrence of any of the following events: (i) the making by Lessee of any general arrangement or assignment for the benefit of creditors; (ii) Lessee's becoming a "debtor" as defined in 11 U.S.C. Section 101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within sixty (60) days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where possession is not restored to Lessee within thirty (30) days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged within thirty (30) days; provided, however, in the event that any provision of this subparagraph (e) is contrary to any applicable law, such provision shall be of no force or effect, and not affect the validity of the remaining provisions.

(f) The discovery by Lessor that any financial statement given to Lessor by Lessee or any Guarantor of Lessee's obligations hereunder was materially false.

(g) If the performance of Lessee's obligations under this Lease is guaranteed: (i) the death of a guarantor, (ii) the termination of a guarantor's liability with respect to this Lease other than in accordance with the terms of such guaranty, (iii) a guarantor's becoming insolvent or the subject of a bankruptcy filing, (iv) a guarantor's refusal to honor the guaranty, or (v) a guarantor's breach of its guaranty obligation on an anticipatory breach basis, and Lessee's failure, within sixty (60) days following written notice by or on behalf of Lessor to Lessee of any such event, to provide Lessor with written alternative assurance or security which, when coupled with the then existing resources of Lessee, equals or exceeds the combined financial resources of Lessee and the guarantors that existed at the time of execution of this Lease.

13.2 REMEDIES. If Lessee fails to perform any affirmative duty or obligation of Lessee under this Lease, within ten (10) days after written notice to Lessee (or in case of an emergency, without notice), Lessor may, at its option (but without obligation to do so), perform such duty or obligation on Lessee's behalf, including, but not limited to, the obtaining of reasonably required bonds, insurance policies, or governmental

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licenses, permits or approvals. The costs and expenses of any such performance by Lessor shall be due and payable by Lessee to Lessor upon invoice therefor. If any check given to Lessor by Lessee shall not be honored by the bank upon which it is drawn, Lessor, at its option, may require all future payments to be made under this Lease by Lessee to be made only by cashier's check. In the event of a Breach of this Lease by Lessee, as defined in Paragraph 13.1, with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such Breach, Lessor may:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease and the term hereof shall terminate and Lessee shall immediately surrender possession of the Premises to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the worth at the time of the award of the unpaid rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided; and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by the Lessee's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, including, but not limited to, the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorneys' fees, and that portion of the leasing commission paid by Lessor applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provision (iii) of the prior sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank Of San



Francisco at the time of award plus one percent. Efforts by Lessor to mitigate damages caused by Lessee's Default or Breach of this Lease shall not waive Lessor's right to recover damages under this Paragraph. If termination of this Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding the unpaid rent and damages as are recoverable therein, or Lessor may reserve therein the right to recover all or any part thereof in a separate suit for such rent and/or damages. If a notice and grace period required under subparagraphs 13.1 (b), (c) or (d) was not previously given, a notice to pay rent or quit, or to perform or quit, as the case may be, given to Lessee under any statute authorizing the forfeiture of leases for unlawful detainer shall also constitute the applicable notice for grace period purposes required by subparagraphs 13.1(b), (c) or (d). In such case, the applicable grace period under subparagraphs 13.1 (b), (c) or (d) and under the unlawful detainer statute shall run concurrently after the one such statutory notice, and the failure of Lessee to cure the Default within the greater of the two such grace periods shall constitute both an unlawful detainer and a Breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession in effect (in California under California Civil Code Section 1951.4) after Lessee's Breach and abandonment and recover the rent as it becomes due, provided Lessee has the right to sublet or assign, subject only to reasonable limitations. See Paragraphs 12 and 36 for the limitations on assignment and subletting, which limitations Lessee and Lessor agree are reasonable Acts of maintenance or preservation, efforts to relet the Premises, or the appointment of a receiver to protect the Lessor's interest under the Lease, shall not constitute a termination of the Lessee's right to possession.

(c) Pursue any other remedy now or hereafter available to Lessor under the laws or judicial decisions of the state wherein the Premises are located.

(d) The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

13.3 LATE CHARGES. Lessee hereby acknowledges that late payment by Lessee to Lessor of rent and other sums due hereunder will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed upon Lessor by the terms of any ground lease, mortgage or trust deed covering the Premises. Accordingly, if any installment of rent or any other sum due from Lessee shall not be received by Lessor or Lessor's designee within ten (10) days after Lessee's receipt of written notice that such amount was not paid when due, then, without any requirement for notice to Lessee, Lessee shall pay to Lessor a late charge equal to six percent (6%) of such overdue amount. The

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parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of late payment by Lessee. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's Default or Breach with respect to such overdue amount, nor prevent Lessor from exercising any of the other rights and remedies granted hereunder.

13.4 BREACH BY LESSOR. Lessor shall not be deemed in breach of this Lease unless Lessor fails within a reasonable time to perform an obligation required to be performed by Lessor. For purposes of this Paragraph 13.4, a reasonable time shall in no event be less than thirty (30) days after receipt by Lessor, and by the holders of any ground lease, mortgage or deed of trust covering the Premises whose name and address shall have been furnished to Lessee in writing for such purpose, of written notice specifying wherein such obligation of Lessor has not been performed; provided, however, that if the nature of Lessor's obligation is such that more than thirty (30) days after such notice are reasonably required for its performance, then Lessor shall not be in breach of this Lease if performance is commenced within such thirty (30) day period and thereafter diligently pursued to completion.

14. CONDEMNATION. If the Premises or any portion thereof are taken under the power of eminent domain or sold under the threat of the exercise of said power (all of which are herein called "condemnation"), this Lease shall terminate as to the part so taken as of the date the condemning authority takes title or possession, whichever first occurs. If so much of the Premises is taken by condemnation as will prevent Lessee, in its reasonable judgment, from conducting its business operations on the Premises in the manner contemplated as of the Commencement Date, Lessee may, at Lessee's option, to be exercised in writing within ten (10) days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within ten (10) days after the condemning authority shall have taken possession), terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the Base Rent shall be equitably reduced based on the reduced utility to Lessee of the remaining portion of the Premises. Any award for the taking of all or any part of the Premises under the power or eminent domain or any payment made under threat of the exercise of such power shall be the property of Lessor, whether such award shall be made as compensation for diminution in value of the leasehold or for the taking of the fee, or as severance damages; provided, however, that Lessee shall be entitled to any compensation separately awarded to Lessee for Lessee's relocation expenses and/or loss of Lessee's Trade Fixtures. In the event that this Lease is not terminated by reason of such condemnation, Lessor shall, to the extent of its net severance damages received over and above the legal and other expenses incurred by Lessor in the condemnation matter, repair any damage to the Premises caused by such condemnation, except to the extent that Lessee has been reimbursed therefor by the condemning authority. Lessee shall be responsible for the payment of any amount in excess of such net severance damages required to complete such repair.

15. BROKERS' FEE.

15.1 The Brokers named in Paragraph 1.10 are the procuring causes of this Lease.

15.2 Lessor shall pay (i) to Lessor's Broker a commission equal to \$186,268.50, one-half of which to be paid on execution of this Lease and one-half on the Commencement Date, and (ii) to Lessee's Broker a commission equal to \$186,268.50, one-half of which to be paid on execution of this Lease and one-half on the Commencement Date, for brokerage services rendered by said Brokers to Lessor in this transaction. In addition, if Lessee exercises the Option set forth in Paragraph 50 of the Addendum, and if Lessee's Broker is actively involved in the negotiations leading to any such renewal, Lessor shall pay to Lessee's Broker any commission payable with respect thereto.

15.3 Any buyer or transferee of Lessor's interest in this Lease, whether such transfer is by agreement or by operation of law, shall be deemed to have assumed Lessor's obligation under this Paragraph 15. Each Broker shall be a third party beneficiary of the provisions of this Paragraph 15 to the extent of its interest in any commission arising from this Lease and may enforce that right directly against Lessor and its successors.

15.4 Lessee and Lessor each represent and warrant to the other that it has had no dealings with any person, firm, broker or finder (other than the Brokers, if any, named in paragraph 1.10) in connection with the negotiation of this Lease and/or the consummation of the transaction contemplated hereby, and that no

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broker or other person, firm or entity other than said named Brokers is entitled to any commission or finder's fee in connection with said transaction. Lessee and Lessor do each hereby agree to indemnify, protect, defend and hold the other harmless from and against liability for compensation or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying Party, including any costs, expenses and attorneys' fees reasonably incurred with respect thereto.

15.5 Lessor and Lessee hereby consent to and approve all agency

relationships, including any dual agencies, indicated in Paragraph 1.10.

16. TENANCY STATEMENT.

16.1 Each Party (as "RESPONDING PARTY") shall within ten (10) days after written notice from the other Party (the "REQUESTING PARTY") execute, acknowledge and deliver to the Requesting party a statement in writing in form similar to the then most current "TENANCY STATEMENT" form published by the American Industrial Real Estate Association, plus such additional information, confirmation and/or statements as may be reasonably requested by the Requesting Party.

16.2 If Lessor desires to finance, refinance, or sell the Premises, any part thereof, or the building of which the Premises are a part, Lessee and all Guarantors of Lessee's performance hereunder shall deliver to any potential lender or purchaser designated by Lessor such financial statements of Lessee and such Guarantors as may be reasonably required by such lender or purchaser, including, but not limited to, Lessee's financial statements for the past three (3) years. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. LESSOR'S LIABILITY. The term "LESSOR" as used herein shall mean the owner or owners at the time in question of the fee title to the Premises, or, if this is a sublease, of the lessee's interest in the prior lease. In the event of a transfer of Lessor's title or interest in the Premises or in this Lease, Lessor shall deliver to the transferee or assignee (in cash or by credit) any unused Security Deposit held by Lessor at the time of such transfer or assignment. Upon such transfer or assignment and delivery of the Security Deposit, as aforesaid, the prior Lessor shall be relieved of all liability with respect to the obligations and/or covenants under this Lease thereafter to be performed by the Lessor. Subject to the foregoing, the obligations and/or covenants in this Lease to be performed by the Lessor shall be binding only upon the Lessor as herein above defined.

18. SEVERABILITY. The invalidity of any provision of this Lease, as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

19. INTEREST ON PAST-DUE OBLIGATIONS. Any monetary payment due Lessor hereunder, other than late charges, not received by Lessor within thirty (30) days following the date on which it was due, shall bear interest from the thirty-first (31st) day after it was due at the rate of 12% per annum, but not exceeding the maximum rate allowed by law, in addition to the late charge provided for in Paragraph 13.4.

20. TIME OF ESSENCE. Time is of the essence with respect to the performance of all obligations to be performed or observed by the Parties under this Lease.

21. RENT DEFINED. All monetary obligations of Lessee to Lessor under the terms of this Lease are deemed to be rent.

22. NO PRIOR OR OTHER AGREEMENTS; BROKER DISCLAIMER. This Lease contains all agreements between the Parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective. Lessor and Lessee each represents and warrants to the Brokers that it has made, and is relying solely upon, its own investigation as to the nature, quality, character and financial responsibility of the other Party to this Lease and as to the nature, quality and character of the Premises. Brokers have no responsibility with respect thereto or with respect to any default or breach hereof by either Party.

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23. NOTICES.

23.1 All notices required or permitted by this Lease shall be in writing and may be delivered in person (by hand or by messenger or courier service) or may be sent by regular, certified or registered mail or U.S. Postal Service Express Mail, with postage prepaid, or by facsimile transmission, and shall be deemed sufficiently given if served in a manner specified in this

Paragraph 23. The addresses noted adjacent to a Party's signature on this Lease shall be that Party's address for delivery or mailing of notice purposes. Either Party may by written notice to the other specify a different address for notice purposes, except that upon Lessee's taking possession of the Premises, the Premises shall constitute Lessee's address for the purpose of mailing or delivering notices to Lessee. A copy of all notices required or permitted to be given to Lessor hereunder shall be concurrently transmitted to such party or parties at such address(es) as Lessor may from time to time hereafter designate by written notice to Lessee.

23.2 Any notice sent by registered or certified mail, return receipt requested, shall be deemed given on the date of delivery shown on the receipt card or, if no delivery date is shown, the postmark thereon. If sent by regular mail the notice shall be deemed given forty-eight (48) hours after the same is addressed as required herein and mailed with postage prepaid. Notices delivered by United States Express Mail or overnight courier that guarantees next day delivery shall be deemed given twenty-four (24) hours after delivery of the same to the United States Postal Service or courier. If any notice is transmitted by facsimile transmission or similar means, the same shall be deemed served or delivered upon telephone confirmation of receipt of the transmission thereof, provided a copy is also delivered via delivery or mail. If notice is received on a Sunday or legal holiday, it shall be deemed received on the next business day.

24. WAIVERS. No waiver by Lessor of the Default or Breach of any term, covenant or condition hereof by Lessee shall be deemed a waiver of any other term, covenant or condition hereof, or of any subsequent Default or Breach by Lessee of the same or of any other term, covenant or condition hereof. Lessor's consent to, or approval of, any act shall not be deemed to render unnecessary the obtaining of Lessor's consent to, or approval of, any subsequent or similar act by Lessee, or be construed as the basis of an estoppel to enforce the provision or provisions of this Lease requiring such consent. Regardless of Lessor's knowledge of a Default or Breach at the time of accepting rent, the acceptance of rent by Lessor shall not be a waiver of any preceding Default or Breach by Lessee of any provision hereof, other than the failure of Lessee to pay the particular rent so accepted. Any payment given Lessor by Lessee may be accepted by Lessor on account of moneys or damages due Lessor, notwithstanding any qualifying statements or conditions made by Lessee in connection therewith, which such statements and/or conditions shall be of no force or effect whatsoever unless specifically agreed to in writing by Lessor at or before the time of deposit of such payment.

25. RECORDING. Either Lessor or Lessee shall, upon request of the other, execute, acknowledge and deliver to the other a short form memorandum of this Lease for recording purposes. The Party requesting recordation shall be responsible for payment of any fees or taxes applicable thereto.

26. NO RIGHT TO HOLDOVER. Lessee has no right to retain possession of the Premises or any part thereof beyond the expiration or earlier termination of this Lease.

27. CUMULATIVE REMEDIES. No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at law or in equity.

28. COVENANTS AND CONDITIONS. All provisions of this Lease to be observed or performed by Lessee are both covenants and conditions.

29. BINDING EFFECT; CHOICE OF LAW. This lease shall be binding upon the parties, their personal representatives, successors and assigns and be governed by the laws of the State in which the Premises are located. Any litigation between the Parties hereto concerning this Lease may be initiated in the county in which the Premises are located.

30. SUBORDINATION; ATTORNMENT; NON-DISTURBANCE.

30.1 SUBORDINATION. This Lease and any Option granted hereby shall be subject and subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively, "SECURITY

Premises are a part, to any and all advances made on the security thereof, and to all renewals, modifications, consolidations, replacements and extensions thereof if, but only if, Lessee receives from the holder and beneficiary of any such Security Device a non-disturbance agreement, satisfactory in form and substance to Lessee, pursuant to which such holder and beneficiary agrees that, in the event such beneficiary or holder takes title to the Premises, whether pursuant to an exercise of its remedies under the Security Device or otherwise, Lessee's rights hereunder shall be honored in accordance with the terms of this Lease (a "NON-DISTURBANCE AGREEMENT").

30.2 ATTORNMENMENT. Subject to Lessee's receipt of a Non-Disturbance Agreement, Lessee agrees to attorn to a Lender or any other party who acquires ownership of the Premises by reason of a foreclosure of a Security Device, and that in the event of such foreclosure, such new owner shall not: (i) be liable for any act or omission of any prior lessor or with respect to events occurring prior to acquisition of ownership, (ii) be subject to any offsets or defenses which Lessee might have against any prior lessor, or (iii) be bound by prepayment of more than one month's rent.

30.3 NON-DISTURBANCE. Lessor shall not enter into any Security Devices from and after the date hereof without providing to Lessee a Non-Disturbance Agreement from the beneficiary and holder under such Security Device.

30.4 SELF-EXECUTING. The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents, provided, however, that, upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of the Premises, Lessee and Lessor shall execute such further writings as may be reasonably required to separately document any such subordination or non-subordination, attornment and/or non-disturbance agreement as is provided for herein.

31. ATTORNEYS' FEES. If a Party or Broker brings an action or proceeding to enforce the terms hereof or declare rights hereunder, the Prevailing Party (as hereafter defined) or Broker in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorneys' fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term, "Prevailing Party" shall include, without limitation, a Party or Broker who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party or Broker of its claim or defense. The attorneys' fees award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. Lessor shall be entitled to attorneys' fees, costs and expenses incurred in the preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach.

32. LESSOR'S ACCESS; SHOWING PREMISES; REPAIRS. Lessor and Lessor's agents shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times for the purpose of showing the same to prospective purchasers, lenders, or lessees, and making such alterations, repairs, improvements or additions to the Premises or to the building of which they are a part, as Lessor may reasonably deem necessary. Lessor may at any time place on or about the Premises or building any ordinary "For Sale" signs and Lessor may at any time during the last one hundred twenty (120) days of the term hereof place on or about the Premises any ordinary "For Lease" signs. All such activities of Lessor shall be without abatement of rent to Lessee provided that such access shall not interfere with Lessee's operations on the Premises.

33. AUCTIONS. Lessee shall not conduct, nor permit to be conducted, either voluntarily or involuntarily, any auction upon the Premises without first having obtained Lessor's prior written consent. Notwithstanding anything to the contrary in this Lease, Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to grant such consent.

34. TERMINATION; MERGER. Unless specifically stated otherwise in writing by Lessor, the voluntary or other surrender of this Lease by Lessee, the mutual termination or cancellation hereof, or a termination hereof by Lessor for Breach by Lessee, shall automatically terminate any sublease or lesser estate in the Premises; provided, however, Lessor shall, in the event of any such surrender, termination or cancellation, have the option to continue any one or all of any existing subtenancies. Lessor's failure within ten (10) days following

any such event to make a written election to the contrary by written notice to the holder of any such lesser interest shall constitute Lessor's election to have such event constitute the termination of such interests.

35. CONSENTS.

(a) Lessor's actual reasonable costs and expenses (including but not limited to architects', attorneys', engineers' or other consultants' fees) incurred in the consideration of, or response to, a request by Lessee for any Lessor consent pertaining to this Lease or the Premises, including but not limited to consents to an assignment, a subletting or the presence or use of a Hazardous Substance, practice or storage tank, shall, in an amount equal to the lesser of Lessor's actual out-of-pocket costs and expenses or \$1,000, be paid by Lessee to Lessor upon receipt of an invoice and supporting documentation therefor. Subject to Paragraph 12.2(e) (applicable to assignment or subletting), Lessor may, as a condition to considering any such request by Lessee, require that Lessee deposit with Lessor an amount of money (in addition to the Security Deposit held under Paragraph 5) reasonably calculated by Lessor to represent the cost Lessor will incur in considering and responding to Lessee's request (but no more than \$1,000). Except as otherwise provided, an unused portion of said deposit shall be refunded to Lessee without interest. Lessor's consent to any act, assignment of this Lease or subletting of the Premises by Lessee shall not constitute an acknowledgment that no Default or Breach by Lessee of this Lease exists nor shall such consent be deemed a waiver of any then existing default or Breach, except as may be otherwise specifically stated in writing by Lessor at the time of such consent.

(b) All conditions to Lessor's consent authorized by this Lease are acknowledged by Lessee as being reasonable. The failure to specify herein any particular condition to Lessor's consent shall not preclude the imposition by Lessor at the time of consent of such further or other conditions as are then reasonable with reference to the particular matter for which consent is being given.

(c) Wherever Lessor's consent or approval is required pursuant to the terms of this Lease, Lessor shall be deemed to have granted its consent if it shall not have objected in writing to a request made by Lessee within five (5) days of Lessee's request, setting forth the detailed reasons for its objection.

(d) Wherever Lessor's consent or approval is required pursuant to the terms of this Lease, Lessor shall be reasonable in granting or withholding its consent or approval.

36. GUARANTOR.

36.1 If there are to be any Guarantors of this Lease per Paragraph 1.11, the form of the guaranty to be executed by each such Guarantor shall be in the form recently published by the American Industrial Real Estate Association, and each said Guarantor shall have the same obligations as Lessee under this Lease, including, but not limited to, the obligation to provide the Tenancy Statement and information called for by Paragraph 16.

36.2 It shall constitute a Default of the Lessee under this Lease if any such Guarantor fails or refuses, upon reasonable request by Lessor, to give:

(a) evidence of the due execution of the guaranty called for by this Lease, including the authority of the Guarantor (and of the party signing on Guarantor's behalf) to obligate such Guarantor on said guaranty, and including in the case of a corporate Guarantor, a certified copy of a resolution of its board of directors authorizing the making of such guaranty, together with a certificate of incumbency showing the signatures of the persons authorized to sign on its behalf, (b) current financial statements of Guarantor as may from time to time be requested by Lessor, (c) a Tenancy Statement, or (d) written confirmation that the guaranty is still in effect.

37. QUIET POSSESSION. Upon payment by Lessee of the rent for the Premises and the observance and performance of all the covenants, conditions and provisions on Lessee's part to be observed and performed under this Lease, Lessee shall have quiet possession of the Premises for the entire term hereof

subject to all of the provisions of this Lease.

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### 38. OPTIONS

38.1 DEFINITION. As used in this Paragraph 38 the word "OPTION" has the following meanings: (a) the right to extend the term of this Lease or to renew this Lease or to extend or renew any lease that Lessee has on other property of Lessor; (b) the right of first refusal to lease the Premises or the right of first offer to lease the Premises or the right of first refusal to lease other property of Lessor or the right of first offer to lease other property of Lessor; (c) the right to purchase the Premises, or the right of first refusal to purchase the Premises, or the right of first offer to purchase the Premises, or the right to purchase other property of Lessor, or the right of first refusal to purchase other property of Lessor, or the right of first offer to purchase other property of Lessor.

38.2 MULTIPLE OPTIONS. In the event that Lessee has any multiple Options to extend or renew this Lease, a later option cannot be exercised unless the prior options to extend or renew this Lease have been validly exercised.

### 38.3 EFFECT OF DEFAULT ON OPTIONS

(a) Lessee shall have no right to exercise an Option, notwithstanding any provision in the grant of Option to the contrary: (i) during the period commencing with the giving of any notice of Default under Paragraph 13.1 and continuing until the noticed Default is cured, or (ii) during the period of time any monetary obligation due Lessor from Lessee is unpaid (without regard to whether notice thereof is given Lessee), or (iii) during the time Lessee is in Breach of this Lease.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 38.3(a).

39. SECURITY MEASURES. Lessee hereby acknowledges that the rent payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of the Premises, Lessee, its agents and invitees and their property from the acts of third parties.

40. RESERVATIONS. Lessor reserves to itself the right, from time to time, to grant, without the consent or joinder of Lessee, such easements, rights and dedications that Lessor deems necessary, and to cause the recordation of parcel maps and restrictions, so long as such easements, rights, dedications, maps and restrictions do not interfere with the use of the Premises by Lessee. Lessee agrees to sign any documents reasonably requested by Lessor to effectuate any such easement rights, dedications, maps or restrictions.

41. PERFORMANCE UNDER PROTESTS. If at any time a dispute shall arise as to any amount or sum of money to be paid by one Party to the other under the provisions hereof, the Party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment and there shall survive the right on the part of said Party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said Party to pay such sum or any part thereof, said Party shall be entitled to recover such sum or so much thereof as it was not legally required to pay under the provisions of this Lease.

42. AUTHORITY. If either Party hereto is a corporation, trust, or general or limited partnership, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on its behalf. If Lessee is a corporation, trust or partnership, Lessee shall, within thirty (30) days after request by Lessor, deliver to Lessor evidence satisfactory to Lessor of such authority.

43. CONFLICT. Any conflict between the printed provisions of this Lease and the typewritten or handwritten provisions shall be controlled by the typewritten or handwritten provisions.

44. OFFER. Preparation of this Lease by Lessor or Lessor's agent and submission of same to Lessee shall not be deemed an offer to lease to Lessee. This Lease is not intended to be binding until executed by all Parties hereto.

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45. AMENDMENTS. This Lease may be modified only in writing, signed by the Parties in interest at the time of the modification. The Parties shall amend this Lease from time to time to reflect any adjustments that are made to the Bass Rent or other rent payable under this Lease. As long as they do not materially change Lessee's obligations hereunder, Lessee agrees to make such reasonable non-monetary modifications to this Lease as may be reasonably required by an institutional, insurance company, or pension plan Lender in connection with the obtaining of normal financing or refinancing of the property of which the Premises are a part.

46. MULTIPLE PARTIES. Except as otherwise expressly provided herein, if more than one person or entity is named herein as either Lessor or Lessee, the obligations of such multiple Parties shall be the joint and several responsibility of all persons or entities named herein as such Lessor or Lessee.

47. COVENANTS AND CONDITIONS. Any provision of this Lease performable by any party hereto shall be deemed both a covenant and a condition.

48. AMERICANS WITH DISABILITIES ACT. Lessor hereby represents and warrants to and for the benefit of Lessee that the Premises, as they are currently used and as Lessee intends to use them, comply in all respects with the Americans with Disabilities Act (the "Act"), and covenants to (a) make all repairs and alterations to the Premises and the improvements thereon that may be required in order to cause the Premises and such improvements to comply with the Act, and any other applicable law, including without limitation repairs and improvements which are necessitated by changes in the Act and any other law, and (b) to indemnify, defend and hold Lessee harmless from and against any and all liability and damages which may occur as a result of a breach of this paragraph 49. This paragraph 49 shall control over any contrary provision of this Lease.

49. UTILITIES AND SERVICES. Lessor hereby represents and warrants to and for the benefit of Lessee that the Premises are currently served by utilities and all other municipal, quasi-municipal and private services (such as, without limitation, electricity, gas, water, waste disposal and street cleaning) as are appropriate for the business operations currently conducted on the Premises and the operations which Lessee intends to operate on the Premises (collectively, the "Services"). Without limiting Lessee's remedies hereunder or at law or equity, Lessor agrees that Lessee shall be entitled to one (1) day of abated rent hereunder for every one (1) day during which any Services are not provided to the Premises, notwithstanding Lessee's commercially reasonable efforts to procure such services, and that, if such interruption continues for a period of more than three (3) consecutive days, then Lessee may, at any point after the expiration of such three (3) consecutive day period, terminate this Lease and Lessee's remaining obligations hereunder.

LESSOR AND LESSEE HAVE CAREFULLY READ AND REVIEWED THIS LEASE AND EACH TERM AND PROVISION CONTAINED HEREIN, AND BY THE EXECUTION OF THIS LEASE SHOW THEIR INFORMED AND VOLUNTARY CONSENT THERETO. THE PARTIES HEREBY AGREE THAT, AT THE TIME THIS LEASE IS EXECUTED, THE TERMS OF THIS LEASE ARE COMMERCIALY REASONABLE AND EFFECTUATE THE INTENT AND PURPOSE OF LESSOR AND LESSEE WITH RESPECT TO THE PREMISES.

The parties hereto have executed this Lease at the place on the dates specified above to their respective signatures.

LESSOR:

PROFICIENCY ONTARIO LIMITED PARTNERSHIP,  
a California limited partnership

By: PROFICIENCY CAPITAL CORPORATION,  
a California corporation, its  
general partner



By: /s/ JEFFREY N. TRENTON

-----  
Name: Jeffrey N. Trenton  
Title: President

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LESSEE:

SKECHERS USA, INC., a California  
corporation

By: /s/ DAVID WEINBERG

-----  
NAME: David Weinberg  
Title: CFO

(ATTACH EXHIBITS A AND B)

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ADDENDUM TO STANDARD INDUSTRIAL/COMMERCIAL  
SINGLE-TENANT LEASE - NET

Lessor: PROFICIENCY ONTARIO LIMITED PARTNERSHIP, a California limited  
partnership

Lessee: SKECHERS USA, INC., a California corporation

Lease Dated: April 10, 1998

The following provisions are added to that certain Standard Industrial/Commercial Single-Tenant Lease-Net (the "PRINTED LEASE") dated for reference purposes as of April 10, 1997 by and between Proficiency Ontario Limited Partnership, a California limited partnership, as Lessor, and Skechers USA, Inc., a California corporation, as Lessee. In the event of any conflict between the terms of the Printed Lease and this Addendum, the terms of this Addendum shall control.

50. OPTION TO EXTEND TERM. Lessee shall have one option (the "OPTION") to extend the Term of the Lease for a period of five (5) years (hereafter the "OPTION PERIOD"), provided that all of the following conditions are satisfied: (a) Lessee shall provide Lessor with written notice (the "OPTION EXERCISE NOTICE") of Lessee's election to exercise the Option not less than one hundred eighty (180) nor more than two hundred ten (210) days prior to the expiration of the Initial Term of the Lease, and (b) no default by Lessee of its obligations under this Lease shall have occurred and be continuing, either at the time Lessee delivers the Option Exercise Notice to Lessor or at the commencement of the Option Period. The Base Rent for Option Period shall be equal to ninety-five percent (95%) of the Fair Market Rental Value (as defined below) for comparable industrial buildings in the City of Ontario, but in no event shall the monthly Base Rent for Option Period be less than the monthly Base Rent for the last month of the Initial Term.

50.1 Upon receipt by Lessor of an Option Exercise Notice, Lessor and Lessee shall confer and attempt to agree upon the initial monthly Base Rent for the Extension Period. If such an agreement is not reached within thirty (30) days following receipt of such notice by Lessor, then Fair Market Rental Value ("FMRV") for the Premises shall be determined as provided in Paragraph 50.2 below.

50.2 To determine FMRV, Lessor shall engage at its sole

cost and expense a MAI certified appraiser ("LESSOR'S APPRAISER") who shall render a written opinion of the FMRV for the Premises ("LESSOR'S FMRV"). Lessee shall have five (5) business days to accept or reject Lessor's FMRV. If Lessee accepts Lessor's FMRV, Lessee shall reimburse Lessor for one-half of the fees and expenses of Lessor's Appraiser. If Lessee rejects such determination of FMRV, Lessee shall engage at its sole cost and expense a second independent MAI certified appraiser ("LESSEE'S APPRAISER") who shall also render a written opinion of the FMRV for the Premises ("LESSEE'S FMRV"). If Lessor's FMRV is less than 10% greater or less than Lessee's FMRV, then the FMRV for the Premises shall be the average of Lessor's FMRV and Lessee's FMRV. If the difference between Lessor's FMRV and Lessee's FMRV is 10% or more, and Lessor and Lessee cannot agree between themselves as to the FMRV for the Premises, then FMRV shall be determined by a third independent MAI certified appraiser (the "THIRD APPRAISER") mutually selected by Lessor's Appraiser and Lessee's Appraiser. The Third Appraiser shall render a written opinion of the FMRV for the Premises, which shall be binding and conclusive upon Lessor and Lessee. The costs of the Third Appraiser shall be shared equally by Lessor and Lessee.

50.3 Except for the option to extend the term of the Lease for one five-year period as provided in this Paragraph 50, Lessee shall have no other option to extend the term of the Lease, or option to purchase, option to lease or right of first refusal.

51. COMMON AREA EXPENSES. Lessee acknowledges that the Premises consists of one building in a Project known as "Ontario Gateway" that currently includes two buildings and may in the future include additional buildings. Lessee shall reimburse Lessor for (or, at the election of Lessor, shall pay directly) all costs required to be paid by the owner of Lot No. 2 (i.e., the Premises) under (i) that certain Declaration of Covenants, Conditions and Restrictions and Reciprocal Easement Agreement dated as of June 19, 1997 and recorded June 27, 1997 as Instrument No. 19970229025 in the Official Records of San Bernardino County, California, and (ii) that certain Declaration of Covenants, Conditions and Restrictions Pertaining to Fire Protection dated as of June 19, 1997 and recorded June 27, 1997 as Instrument No. 19970229024 in the Official Records of San Bernardino County, California. In addition to the foregoing, Lessee agrees to pay, to the extent not included in the foregoing, its "PROPORTIONATE SHARE" of the following expenses, which shall hereafter be referred to as "COMMON AREA EXPENSES": landscape maintenance, truck court sweeping, centralized fire sprinkler alarm monitoring and any other reasonable and necessary expenses incurred by Landlord to maintain the Common Areas in a first-class manner. All Common Area Expenses shall be reasonable and competitive. Lessee's Proportionate Share shall be a fraction, the numerator of which is 285,600 (the rentable square feet of the Premises) and the denominator of which shall be the sum of the rentable square feet of all buildings in the Ontario Gateway Project. Lessor shall have the option either (a) to bill Lessee in arrears for Lessee's Proportionate Share of Common Area Expenses, in which case Lessee shall pay to Lessor, as additional Rent, Lessee's Proportionate Share of Common Area Expenses within ten (10) days after receiving any invoice therefor, or (b) to estimate the annual amount of Lessee's Proportionate Share of Common Area Expenses, in which case Lessee shall pay to Lessor each month one-twelfth of the annual amount estimated by Lessor for Lessee's Proportionate Share of Common Area Expenses. If Lessor elects to estimate Common Area Expenses as provided in clause (b) above, Lessor shall provide to Lessee within one hundred twenty (120) days after the end of each calendar year a reasonably detailed statement showing the actual Common Area Expenses for the preceding calendar year, and a reconciliation of the actual amount of Common Area Expenses with the estimated amounts paid by Lessee during the previous calendar year. In the event that Lessee shall have paid more than the actual amount of Lessee's Proportionate Share of Common Area Expenses for the preceding calendar year, any such overpayment shall be credited against the next month(s) payment of Base Rent. In the event that Lessee shall have paid less than the actual amount of Lessee's Proportionate Share of Common Area Expenses for the preceding calendar year, any such underpayment shall be due and payable within ten (10) days following the delivery of such reconciliation by Lessor to Lessee.

52. TENANT IMPROVEMENTS. On or before the Commencement Date, Lessor shall perform the following tenant improvement work (collectively, "TENANT IMPROVEMENTS") at Lessee's sole cost and expense (subject to application of the Improvement Allowance described below): (a) construct standard office space of approximately 5,600 square feet using standard building materials using the following configurations (i) 5,000 square feet of main office, including three

(3) private offices of approximately 11' x 13', (ii) office restrooms, including one men's room with one stall and two urinals and one women's room with two stalls, (iii) a lunch room with approximately 2,000 square feet, and (iv) 600 square feet of shop office, shop restrooms (with a men's room containing 2 stalls and 3 urinals and a women's room with 5 stalls); (b) install 500 metal halide lighting fixtures in the warehouse; (c) install 40 hydraulic pit levelers with dock seals and dock lights on every other door; and (e) install any necessary exterior fencing (provided that the portion of the cost thereof to be paid out of the Improvement Allowance shall not exceed \$75,000). Lessee acknowledges and agrees that (i) any such fencing shall be subject to the approval rights, if any, of the City of Ontario and California Edison, and (ii) in no event shall any delays in the installation of such fencing delay or otherwise extend the date Lessee shall commence occupancy. In addition to the foregoing work, the term "TENANT IMPROVEMENTS" shall include a distribution system for electricity acceptable to both Parties, provided, however, that only those portions of the costs thereof agreed to in advance by Lessor shall be paid for out of, or applied as a credit against, the Improvement Allowance.

52.1 All space planning and working drawings with respect to the construction and installation of the Tenant Improvements shall be prepared by Lessor's architect(s) and/or space planner(s). Within five (5) business days after the execution of this Lease by both parties, Lessee shall provide to

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Lessor all of the information and requirements necessary for the Lessor to prepare a preliminary space plan (the "Preliminary Space Plan"). Lessor shall provide the Preliminary Space Plan to Lessee within five (5) business days after receipt of such information and requirements. Lessee shall review and, subject to Lessor addressing any comments of Lessee, approve the Preliminary Space Plan within three (3) business days after receipt thereof. Lessor shall in good faith consider any changes to the Preliminary Space Plan proposed by Lessee, and use commercially reasonable efforts to address same as long as such changes do not increase the time necessary to construct the Tenant Improvements or materially increase the cost of the Tenant Improvements. If any such changes to the Preliminary Space Plan proposed by Lessee would increase the cost of the Tenant Improvements, Lessor may condition its approval on Lessee's agreement to pay such additional costs (and deposit in cash the amount of such additional costs with Lessor). Within three (3) business days after approval of the Preliminary Space Plan, Lessee shall provide Lessor with the information and requirements necessary for the Lessor to prepare the final working drawings (the "SPACE PLAN"), including, without limitation, the finishes and Lessee's electrical requirements and racking plan. Lessor shall provide the Space Plan to Lessee within ten (10) business days after receipt of such information and requirements. Lessee shall review and, subject to Lessor addressing any remaining comments of Lessee, approve the Space Plan within three (3) business days after receipt thereof. Subject to Compliance with the 3-business day review period set forth herein, no final working drawings shall be submitted by Lessor to any governmental authority for purposes of obtaining a building permit unless and until such drawings have been so approved by Lessee.

52.2 Lessee agrees to cooperate with Lessor in the design, construction and installation of the Tenant Improvements, and agrees to respond promptly to any request for information from Lessor. Lessee further acknowledges that the Commencement Date specified in Paragraph 1.3 of the Printed Lease is dependent on the timely completion of working drawings and plans and specifications for the Tenant Improvements, the availability materials to construct the Tenant Improvements, the receipt of governmental approvals and events of force majeure. In the event that a delay in access to or completion or occupation of the Premises is occasioned by any of the foregoing, the Commencement Date shall be extended accordingly, provided that the length of the initial term of the Lease shall, in no event, be shortened in the event of such a delay.

52.3 Lessor shall provide Lessee with a credit against the cost of the Tenant Improvements in the amount of \$625,000 (the "IMPROVEMENT ALLOWANCE"). In no event shall any unused portion of the Improvement Allowance be used as a credit against other obligations of Lessee (including, without limitation, the payment of Base Rent) or for any other purpose whatsoever. Upon completion of the Space Plan, Lessor shall provide Lessee with its estimate of the total cost of the Tenant

Improvements. If the total cost of the Tenant Improvements exceeds the Improvement Allowance, Lessee shall pay to Lessor, within ten (10) days after the delivery of such estimate, the amount by which the total cost of the Tenant Improvements exceeds the Improvement Allowance.

53. LIMITATION ON USE OF PAVED AREA. Lessee acknowledges it cannot park any vehicles nor store any items on the portions of the paved area indicated as "Restricted Area" on Exhibit B and that the Lessee's use thereof shall be limited to access to and from the Premises.

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EXHIBIT "A"

THAT PORTION OF THE SOUTH ONE-HALF OF THE SOUTHEAST ONE-QUARTER OF SECTION 29, TOWNSHIP 1 SOUTH, RANGE 6 WEST, SAN BERNARDINO BASE AND MERIDIAN, LYING WEST OF THE EASTERLY LINE OF THE WESTERLY 330.00 FEET OF THE SOUTHEAST ONE-QUARTER OF THE SOUTHEAST ONE-QUARTER OF SAID SECTION 29, TOGETHER WITH THAT PORTION LYING EASTERLY OF THE EASTERLY LINE OF THE WESTERLY 330.00 FEET OF THE SOUTHEAST ONE-QUARTER OF THE SOUTHEAST ONE-QUARTER OF SAID SECTION 29 AND LYING SOUTHERLY OF THE WESTERLY PROLONGATION OF THE SOUTHERLY LINE OF PARCEL NO. 3, PARCEL MAP 227, AS PER MAP RECORDED IN BOOK 3, PAGE 44 OF PARCEL MAPS, IN THE OFFICE OF THE COUNTY RECORDER OF SAID COUNTY, TOGETHER WITH THAT PORTION OF PARCEL 3, PARCEL MAP 9252, AS PER MAP RECORDED IN BOOK 107, PAGES 75 THROUGH 82 OF PARCEL MAPS, IN THE OFFICE OF THE COUNTY RECORDER OF SAID COUNTY, DESCRIBED AS LYING WESTERLY OF THE FOLLOWING DESCRIBED LINE:

BEGINNING AT A POINT IN THE NORTHERLY LINE OF SAID PARCEL 3, PARCEL MAP NO. 9252, DISTANT THEREON NORTH 89 DEG. 48' 38" WEST 380.00 FEET FROM THE NORTHEAST CORNER OF SAID PARCEL 3, SAID POINT HEREINAFTER BEING REFERRED TO AS POINT A; THENCE SOUTH 89 DEG. 48' 38" EAST 9.00 FEET TO THE TRUE POINT OF BEGINNING; THENCE SOUTH 45 DEG. 11' 22" WEST 12.73 FEET TO A POINT IN A LINE WHICH BEARS SOUTH 00 DEG. 11' 22" WEST AND PASSES THROUGH SAID POINT A, SAID POINT BEING DISTANT THEREON SOUTH 00 DEG. 11' 22" WEST 9.00 FEET FROM SAID POINT A; THENCE SOUTH 00 DEG. 11' 22" WEST 163.91 FEET TO A POINT IN THE SOUTHWESTERLY LINE OF SAID PARCEL 3, ALSO BEING THE NORTHEASTERLY LINE OF JURUPA STREET, 120.00 FEET IN WIDTH AS SHOWN ON SAID PARCEL MAP, SAID POINT BEING THE POINT OF ENDING.

EXCEPTING THEREFROM THAT PORTION LYING WITHIN THE SOUTH 315.00 FEET OF THE EAST 375.00 FEET OF SAID SOUTHEAST QUARTER OF SECTION 29.

ALSO EXCEPTING THEREFROM THAT PORTION LYING EASTERLY OF THE FOLLOWING DESCRIBED LINE:

BEGINNING AT THE NORTHWEST CORNER FOR THE SOUTH 315.00 FEET OF THE EAST 375.00 FEET OF SAID SOUTHEAST QUARTER OF SECTION 29; THENCE SOUTH 89 DEG. 48' 38" EAST 19.64 FEET TO THE TRUE POINT OF BEGINNING; THENCE IN 00 DEG. 11' 22" EAST 287.33 FEET TO SAID WESTERLY PROLONGATION FOR THE SOUTHERLY LINE OF PARCEL NO. 3, PARCEL MAP NO. 227, AS PER MAP RECORDED IN BOOK 3, PAGE 44 OF PARCEL MAPS, IN THE OFFICE OF THE COUNTY RECORDER OF SAID COUNTY.

ALSO EXCEPTING THEREFROM THAT PORTION OF SAID LAND LYING NORTHERLY AND WESTERLY OF THE FOLLOWING DESCRIBED LINES:

BEGINNING AT THE INTERSECTION OF THE WESTERLY PROLONGATION OF THE SOUTHERLY LINE OF PARCEL NO. 3, PARCEL MAP 227, AS PER MAP RECORDED IN BOOK 3, PAGE 44 OF PARCEL MAPS, IN THE OFFICE OF THE COUNTY RECORDER OF SAID COUNTY WITH THE EASTERLY LINE OF THE WESTERLY 330.00 FEET TO THE SOUTHEAST ONE-QUARTER OF THE SOUTHEAST ONE-QUARTER OF SAID SECTION 29; THENCE PARALLEL WITH THE SOUTHERLY LINE OF SAID SECTION 29, NORTH 89 DEG. 48' 38" WEST 405.98; THENCE SOUTH 00 DEG. 11' 22" WEST 485.20; THENCE SOUTH 44 DEG. 48' 38" EAST 79.19 FEET; THENCE SOUTH 18 DEG. 59' 22" WEST 100.00 FEET TO THE SOUTHWESTERLY LINE OF PARCEL 3 OF SAID PARCEL MAP 9252, ALSO BEING THE NORTHEASTERLY LINE OF JURUPA STREET, 120.00 FEET IN WIDTH AS SHOWN ON SAID PARCEL MAP.

ALSO EXCEPT THEREFROM, ALL URANIUM, THORIUM AND OTHER FISSIONABLE MATERIALS, ALL OIL, GAS PETROLEUM, ASPHALTUM, AND OTHER HYDROCARBON SUBSTANCES AND OTHER MINERALS AND MINERAL ORES OF EVERY KIND AND CHARACTER, WHETHER SIMILAR TO THESE HEREIN SPECIFIED OR NOT, WITHIN OR UNDERLYING, OR WHICH MAY BE PRODUCED FROM THE HEREINBEFORE DESCRIBED LAND, TOGETHER WITH THE RIGHT TO USE THAT PORTION ONLY OF SAID LAND WHICH UNDERLIES A PLANE PARALLEL TO AND 500 FEET BELOW THE PRESENT SURFACE OF SAID LAND, FOR THE PURPOSE OF PROSPECTING FOR, DEVELOPING AND/OR EXTRACTING SAID URANIUM, THORIUM, AND OTHER FISSIONABLE MATERIALS, OIL, GAS,

PETROLEUM, ASPHALTUM AND OTHER MINERAL OR HYDROCARBON SUBSTANCES FROM SAID LAND, IT BEING EXPRESSLY UNDERSTOOD AND AGREED THAT SAID SOUTHERN SURPLUS REALTY CO., ITS SUCCESSORS AND ASSIGNS, SHALL HAVE NO RIGHT TO ENTER UPON THE SURFACE OF SAID LAND, OR TO USE SAID LAND OR ANY PORTION THEREOF TO SAID DEPTH OF 500 FEET, FOR ANY PURPOSE WHATSOEVER, AS EXCEPTED AND RESERVED IN THE DEED FROM SOUTHERN SURPLUS REALTY CO., A CORPORATION, RECORDED NOVEMBER 22, 1977 IN BOOK 9310 PAGE 132 OFFICIAL RECORDS.

SAID LAND IS DESCRIBED PURSUANT TO A CERTIFICATE APPROVING A LOT LINE ADJUSTMENT, OWNERS CERTIFICATE NO. LL97-04, BY THE CITY OF ONTARIO, RECORDED MAY 1, 1997 AS INSTRUMENT NO. 97-154370, OFFICIAL RECORDS, AND AS CORRECTED BY AMENDED LOT LINE ADJUSTMENT RECORDED JUNE 19, 1997 AS INSTRUMENT NO. 216046, OFFICIAL RECORDS.

CONCEPTUAL SITE PLAN

ONTARIO GATEWAY  
ONTARIO, CALIFORNIA  
FOR PROFICIENCY CAPITAL CORPORATION

EXHIBIT B

[Graphical floor plan of the warehouse building which is the subject of the lease, located at 5725 East Jurupa Street, City of Ontario, County of San Bernardino, State of California. The left hand corner of the graphic includes a rectangle depicting the building itself. Below the rectangle is a road running to the left and right of the page, entitled "Jurupa Street." Another depiction of a road runs along the right side of the floorplan. A full description of the floorplan appears in Exhibit A of the lease.]

EXHIBIT 23.1

AUDITORS REPORT ON SCHEDULE AND CONSENT

The Board of Directors  
Skechers U.S.A., Inc.

The audits referred to in our report dated March 19, 1998, except for the second paragraph of note 5 and note 13 which are as of July 1, 1998, included the related financial statement schedule as of December 31, 1997, and for each of the years in the three-year period ended December 31, 1997, included in the registration statement. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We consent to the use of our reports included herein and to the reference to our firm under the headings "Selected Financial Data" and "Experts" in the prospectus.

KPMG Peat Marwick LLP

Los Angeles, California  
July 28, 1998

WARNING: THE EDGAR SYSTEM ENCOUNTERED ERROR(S) WHILE PROCESSING THIS SCHEDULE.

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM BALANCE SHEETS AND THE STATEMENTS OF OPERATIONS FILED AS PART OF THE COMPANY'S REGISTRATION STATEMENT ON FORM S-1 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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EXHIBIT 99.1

CONSENT OF NOMINATED DIRECTOR

The undersigned hereby consents to his nomination to serve on the Board of Directors of SKECHERS U.S.A., INC. and to all references to said nomination included in or made a part of this Registration Statement.

July 24, 1998

/s/ RICHARD SISKIND

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Richard Siskind