

SECURITIES AND EXCHANGE COMMISSION

FORM 10QSB

Optional form for quarterly and transition reports of small business issuers under section 13 or 15(d)

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FILER

LEE PHARMACEUTICALS

CIK: **58411** | IRS No.: **952680312** | State of Incorp.: **CA** | Fiscal Year End: **0930**
Type: **10QSB** | Act: **34** | File No.: **001-07335** | Film No.: **1697011**
SIC: **2844** Perfumes, cosmetics & other toilet preparations

Mailing Address	Business Address
1444 SANTA ANITA AVENUE	1444 SANTA ANITA AVE
1444 SANTA ANITA AVENUE	SOUTH EL MONTE CA 91733
SOUTH EL MONTE CA 91733	8184423141

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended June 30, 2001

OR

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

For the transition period from _____ to _____

Commission file number 1-7335

LEE PHARMACEUTICALS

(Exact name of small business issuer as specified in its charter)

California

(State or other jurisdiction of incorporation
or organization)

95-2680312

(I.R.S. Employer Identification No.)

1444 Santa Anita Avenue, South El Monte, California 91733

(Address of principal executive offices)

(Zip Code)

(6 2 6) 4 4 2 - 3 1 4 1

(Registrant's telephone number, including area code)

N / A

(Former name, former address and former fiscal year, if changed since last report)

As of June 30, 2001 there were outstanding 4,135,162 shares of common stock of the registrant.

Transitional Small Business Disclosure Format (check one):

Yes ☐ No ☒

LEE PHARMACEUTICALS

BALANCE SHEET

JUNE 30, 2001

(Dollars in thousands)

(Unaudited)

ASSETS

Current assets:	
Cash	\$3
Accounts and notes receivable (net of allowances: \$397)	621
Inventories (net of reserves: \$465)	
Raw materials	\$1,974
Work in process	295
Finished goods	414
Total inventories	2,683
Other current assets	637
Total current assets	3,944
Property, plant and equipment (less accumulated depreciation and amortization: \$5,131)	456
Intangibles and other assets (net of accumulated amortization: \$7,692)	2,846
TOTAL	\$7,246

See notes to financial statements.

LIABILITIES

Current liabilities:

Bank overdraft	\$ 75
Notes payable - bank	794
Current portion - notes payable, other	1,211
Current portion - note payable related party	640
Accounts payable	1,359
Other accrued liabilities	427
Environmental cleanup liability	366
Due to related parties	806
Deferred income	108
Total current liabilities	5,786
Long-term liabilities:	
Long-term notes payable to related parties	2,192
Long-term notes payable, other	1,250
Deferred income	224
Environmental cleanup liability - Casmalia Site	374
Total long-term liabilities	4,040
Total liabilities	9,826
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS' (DEFICIT)	
Common stock, \$.10 par value; authorized, 7,500,00 shares; issued and outstanding, 4,135,162 shares	413
Additional paid-in capital	4,222
Accumulated (deficit)	(7,215)
Total stockholders' deficit	(2,580)
TOTAL	\$ 7,246

See notes to financial statements.

LEE PHARMACEUTICALS
STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share amounts)
(Unaudited)

For the Three Months
Ended June 30,

For the Nine Months
Ended June 30,

	2001	2000	2001	2000
Gross revenues	\$2,074	\$2,063	\$7,157	\$ 7,326
Less: Sales returns	(71)	(208)	(619)	(667)
Cash discounts and others	(18)	(21)	(58)	(64)
Net revenues	1,985	1,834	6,480	6,595
Costs and expenses:				
Cost of sales	1,072	833	3,311	3,099
Selling and advertising expense	510	532	1,796	1,999
General and administrative expense	313	267	859	859
Interest expense	182	208	603	647
Total costs and expenses	2,077	1,840	6,569	6,604
(Loss) from operations	(92)	(6)	(89)	(9)
Other income	107	17	133	48
Net income	\$15	\$11	\$44	\$ 39
Per share:				
Net income	\$0.00	\$0.00	\$0.01	\$.01

See notes to financial statements.

LEE PHARMACEUTICALS
STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	For the Nine Months Ended June 30,	
	2001	2000
Cash flows from operating activities:		
Net income	\$44	\$39
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	128	114
Amortization of intangibles	362	664
(Decrease) in deferred income	(11)	(48)
(Gain) on disposal of property, plant, and equipment	(2)	(1)
Change in operating assets and liabilities:		

Decrease in accounts receivable	425	103
Increase in allowance for doubtful accounts and sales returns and allowances	52	65
(Increase) in inventories	(396	) (105
(Increase) in deposits	(55	) (78
(Increase) decrease in other current assets	(89	) 107
Increase in accounts payable and accrued liabilities	467	34
Increase in due to related parties - accrued interest	73	76
(Decrease) in accrued royalties	(39	) (3
Increase in deferred income and advance payments	350	-
Net cash provided by operating activities	1,309	967
Cash flows from investing activities:		
Additions to property, plant, and equipment	(53	) (219
Proceeds from sale of equipment	7	1
Acquisition of product brands	(199	) (194
Increase in non-current deposit	(11) -
Net cash (used in) investing activities	(256	) (412
Cash flows from financing activities:		
Proceeds from notes payable to related party	44	-
(Payments on) notes payable to related party	(135	) (4
Decrease in due from related party	25	39
(Decrease) in notes payable	(142	) (18
Proceeds from notes payable, other	750	800
Payments on notes payable, other	(1,329	) (1,383
(Decrease) increase in bank overdraft	(275	) 12
Net cash (used in) financing activities	(1,062	) (554
Net (decrease) increase in cash	(9	) 1
Cash, beginning of year	12	4
Cash, end of year	\$3	\$5
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	\$525	\$538
Taxes	\$1	\$1
Non cash financing and investing activity:		
Acquisition of product brands:		
Fair value of assets acquired	\$199	\$394
Fair value of liabilities incurred	-	(200
Net cash payments	\$199	\$194

Notes to Financial Information

1. Basis of presentation:

The condensed interim financial statements included herein have been prepared by Lee Pharmaceuticals without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments which, in the opinion of management, are necessary for a fair presentation of the information contained herein. It is suggested that these condensed financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-KSB for the year ended September 30, 2000. The Company follows the same accounting policies in preparation of interim reports. The results of operations for the three and nine months ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending September 30, 2001 or any other period.

The Company is involved in various matters involving environmental cleanup issues. See "Item 2. Management's Discussion and Analysis or Plan of Operations" and Note 11 of Notes to Financial Statements included in the Company's Form 10-KSB for the fiscal year ended September 30, 2000. The ultimate outcome of these matters cannot presently be determined. Environmental expenditures that relate to an existing condition caused by past operations, and which do not contribute to current or future revenue generation, are expensed. The Company's proportionate share of the liabilities are recorded when environmental remediation and/or cleanups are probable, and the costs can be reasonably estimated.

In May 2001, the Company sold one of its product brands for \$375,000 cash. Included in the sales price is \$25,000 for goodwill and \$350,000 for three service agreements with the buyer. In addition, the Company has agreed to manufacture the product for the buyer for two years. The service agreements call for the Company to provide the buyer with technical and marketing strategy assistance for the three years and customer service assistance for four years. The amount received for the goodwill has been recorded as income and included in other income on the statement of operations. The amounts received for the service agreements have been recorded as deferred income on the balance sheet and income will be recognized over the life of the agreements, which is approximately \$9,000 per month. For the current period ending June 30, 2001, \$18,000 has been recognized in other income, \$108,000 is included in current liabilities and \$224,000 is included in long-term liabilities.

2. Continued existence:

The Company has suffered substantial recurring losses from operations and has a working capital deficiency. The Company must increase revenue and profitability and obtain additional equity and/or debt financing in order to continue to operate. The Company has taken certain actions in an effort to become profitable and improve cash flow from operations in the future. These actions include seeking new revenue opportunities and additional financing sources. Management continues to implement plans to increase revenues, reduce existing cost structures and improve operating efficiencies. There can be no assurance that management will be successful in the implementation of its plans.

3. Earnings per share:

The Company has a simple capital structure, and there were no changes under the SFAS 128 methodology to the previously reported earnings (loss) per share amounts for any of the fiscal years. Basic earnings per share under SFAS 128 were computed using the weighted average number of shares outstanding of 5,194,496 in June 2001 and 4,135,162 in June 2000. Differences in the weighted average number of shares outstanding for purposes of computing diluted earnings per share were due to the inclusion of the dilutive effect of stock options previously

granted. These differences in the weighted average number of shares outstanding for the calculation of basic and diluted earnings per share resulted in no differences in the earnings per share.

4. Acquisitions:

On November 15, 1999, the Company purchased certain assets of the product lines from U.S. Dermatologics, Inc. which includes Cope[®], a tension headache relief tablet, and Astring-o-Sol[®], a concentrated mouthwash, for \$400,000. The Company has remitted \$200,000 at closing and is required to make twenty-four equal monthly installments of \$8,000 plus interest at a rate equal to the highest prime rate (published in the Wall Street Journal) during the preceding month commencing January 25, 2000 and ending on December 25, 2001, and a final payment of all remaining principal due on January 25, 2002. Included in the above purchase price was certain inventories valued at approximately \$60,000. The balance of \$340,000 is for an eight year covenant not to compete.

On January 31, 2000, the Company purchased certain assets of the product Serutan[®], toasted granules, a bulk-forming laxative, for \$60,000 cash. Included in the purchase price was certain inventories valued at approximately \$6,000. The balance of \$54,000 is for an eight year covenant not to compete.

On October 30, 2000, the Company purchased certain assets of the Sloans[®] liniment temporary pain relief product from C.B. Fleet Co., Inc. for \$50,000 plus approximately \$600 of inventory. The Company remitted the full \$50,000 at closing. The balance of \$50,000 is for a five year covenant not to compete.

On February 12, 2001, the Company purchased certain assets of the Black Draught[®] laxative product line from The Monticello Companies, Inc., for \$185,000. This amount includes approximately \$37,000 of inventory and was remitted in full at closing. The balance of \$148,000 is for a five year covenant not to compete.

5. Related party transactions:

During the quarter ended June 30, 2001, non-cash transactions were recorded whereby \$25,000 in prior cash advances to related parties were prepaid and offset against long-term notes of the same amount, due to the same related parties.

6. Miscellaneous income:

For the quarter ending June 30, 2001, the Company settled an outstanding debt of \$352,000 for \$270,000. The difference of \$82,000 has been recorded as a relief of debt and is included in other income on the statement of operations.

7. Income taxes:

As of September 30, 2000, the Company had net operating loss (NOL) carryforwards of approximately \$10,000,000 for Federal and \$2,200,000 for California which for tax purposes can be used to offset future Federal and California income taxes. The differences in the state carryforwards relate primarily to the treatment of loss carryforwards and depreciation of property, plant and equipment. The Federal carryforwards expire from 2005 through 2020; California expires from 2001 through 2004. The Company has provided an allowance for the entire amount of the deferred asset applicable to the NOL.

8. Line of credit:

Effective February 20, 2001, the Company renewed its accounts receivable financing, maturing May 2003, whereby 75% of the eligible domestic accounts receivable, not to exceed the greater of \$1,400,000 or \$1,400,000 less amounts advanced on inventory can be advanced. The agreement is renewable for successive one year periods. Also, the agreement requires minimum monthly interest of \$3,000 with an interest rate of 8% above Union Bank of California's prime rate. The financing agreement includes a \$300,000 term loan on inventory which is incorporated in the working capital line of credit above. The inventory term loan requires monthly payments of \$5,000 with an interest rate

of 8% above Union Bank of California's prime rate. Additionally, there is a separate \$400,000 term loan on the Company's equipment. This financing is secured by a security interest in all of the Company's assets and requires monthly payments of \$10,000 plus interest at Union Bank of California's prime rate plus 8%. The continuing personal guarantee by the Company's President, of obligations of the Company, remains in force.

9. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

10. Litigation:

The Company is subject to certain legal proceedings, claims and litigation arising in the ordinary course of business (other than relating to the environmental issue discussed in Management's Discussion and Analysis). While the amounts claimed may be substantial, the ultimate liability cannot presently be determined because of considerable uncertainties that exist. Therefore, it is possible the outcome of such legal proceedings, claims and litigation could have a material effect on quarterly or annual operating results or cash flows when resolved in a future period. However, based on facts currently available, other than the environmental issue discussed in Management's Discussion and Analysis, management believes such matters will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Item 2.

Management's Discussion and Analysis or Plan of Operations

Material Changes in Results of Operations

Three Months Ended June 30, 2001, and June 30, 2000

Gross revenues for the three months ended June 30, 2001, were \$2,074,000, an increase of approximately \$11,000 from the comparable three months ended June 30, 2000. The increase in gross revenues was principally due to the higher volume (\$85,000) in sales of the Lee[®] Lip-Ex[™] line of products. In addition, the Company reported sales volume increases in depilatories (\$34,000), several personal care category of brands (\$71,000), and the added sales of the newly acquired brands (\$67,000). The above increases were offset by a reduction in sales of Take-Off[®] (\$40,000) and other over-the-counter items (\$148,000).

Net revenues increased approximately \$151,000 or 8% for the three months ended June 30, 2001 as compared to the three months ended June 30, 2000. The change in net revenues was due to the same explanations discussed above along with a decline in sales returns of approximately \$137,000 or 66% when comparing fiscal years 2001 and 2000. Most of these returns had been provided for by way of prior period reserve. These sales returns relate to the discontinuance of one of the Company's SKU's (stock keeping unit) at the retail store level, and continued product returns of a brand containing phenylpropanolamine (PPA) which the Food & Drug Administration (FDA) ruled as a nonmonograph during early calendar year 2000.

Cost of sales increased \$239,000 for the three months ended June 30, 2001 versus June 30, 2000. Cost of sales as a percentage of gross revenues was 52% for the three months ended June 30, 2001 compared to 40% for the comparative three months period ended June 30, 2000. The higher cost of sales percentage was due to a change in the product mix and lower priced commodity-type goods with an accompanying higher cost of goods associated to them, thereby generating lower gross margins on sales of these related products. Also, the Company incurred increased raw material costs, higher direct labor costs as a result of a rise in the minimum hourly wage (\$6.25 effective January 1, 2001 vs. \$5.75) and increased building rental expense due to the Consumer Price Index (CPI) adjustment.

Selling and advertising expenses decreased \$22,000 or 4% when comparing the three months ended June 30, 2001, with the three months ended June 30, 2000. The decrease in expenses was primarily due to lower amortization expense because of the finalization of several write-

off periods associated with prior product brand acquisitions and reduced sales aid expenses. The above expenses were partially offset by increases in travel and entertainment, additional convention/show costs the result of an increase in the number of shows attended and the replacement of an outside sales person at a higher salary plus fringe benefits.

General and administrative expenses increased \$46,000 or 17% when comparing the three months ended June 30, 2001 versus June 30, 2000. The increase in expenses was due to increased travel and entertainment, higher building rental expenses as a result of a Consumer Price Index (CPI) adjustment, a loan fee associated with the Company's asset based financing lender which was non-existent in fiscal year 2000 and increased printing material costs. The above increases were principally offset by lower consulting expenses.

Interest expense decreased \$26,000 or 13% when comparing the three months ended June 30, 2001, with the three months ended June 30, 2000. The decrease was due to reduced borrowings from the Company's related parties along with a lower average prime interest rate (7.35% vs. 9.25%) in reference to certain loans which are tied to prime.

Other income was \$107,000, as compared to \$17,000 in the prior three months ended June 30, 2000, an increase of \$90,000 or 529%. This significant increase was primarily attributable to the Company's settlement of an outstanding debt of \$352,000 for \$270,000. The difference of \$82,000 was recorded as a relief of debt and is included in other income.

Material Changes in Results of Operations

Nine Months Ended June 30, 2001, and June 30, 2000

Gross revenues for the nine months ended June 30, 2001, were \$7,157,000, a decrease of approximately \$169,000 or 2% from the comparable nine months ended June 30, 2000. This decrease was caused by a reduction in sales of Take-Off[®] (\$247,000), depilatories (\$189,000) and other over-the-counter items (\$526,000). This was offset by an increase in gross revenues due to the significant increase (\$544,000) in sales of the Lee[®] Lip-Ex[™] line of products. In addition, the Company reported sales volume increases in Nosebetter[®], along with several over-the-counter category of brands and the added sales of newly acquired brands. These accounted for approximately \$268,000 in increases.

Net revenues for the nine months ended June 30, 2001 were \$6,480,000, a decrease of \$115,000 or 2% from the comparable nine months ended June 30, 2000. The change in net revenues was principally due to the same explanations discussed above. The Company's sales returns decreased approximately \$48,000 or 7% when comparing fiscal years 2001 and 2000. The Company continues to experience returns, as a result of the discontinuance of one of the Company's SKU's (stock keeping unit) at the retail store level and the continued product returns of a brand containing phenylpropanolamine (PPA) which the Food & Drug Administration (FDA) ruled as a nonmonograph during early calendar year 2000.

Cost of sales increased \$212,000 for the nine months ended June 30, 2001 versus June 30, 2000. Cost of sales as a percentage of gross revenues for the nine months ended June 30, 2001, as compared to the nine months ended June 30, 2000, was 46% versus 42% respectively. The higher cost of sales percentage was due to a change in the product mix and lower priced commodity-type goods with an accompanying higher cost of goods attached to them, thereby generating lower gross margins on sales of these related products. In addition, the Company incurred higher raw material costs, increased direct labor costs as a result of a rise in the minimum hourly wage (\$6.25 effective January 1, 2001 vs. \$5.75) and increased building rental expense due to the Consumer Price Index (CPI) adjustment.

Selling and advertising expenses decreased \$203,000 or 10% when comparing the nine months ended June 30, 2001, with the nine months ended June 30, 2000. The decrease in expenses was primarily due to lower amortization expense (\$280,000) because of the finalization of several write-off periods associated with prior product brand acquisitions, less royalty expenses (\$24,000) and lower sales aid expenses (\$16,000). The above decreases were offset by increased convention/show expense (\$16,800) as a result of more shows attended, increased travel and entertainment expenses (\$49,800), higher salesmen salaries and related fringe benefits due to the addition of an outside sales person (\$65,000).

General and administrative expenses were consistent when comparing the nine months ended June 30, 2001, with the nine months ended June 30, 2000.

Interest expense decreased \$44,000 or 7% when comparing the nine months ended June 30, 2001, with the nine months ended June 30, 2000. This decrease was due to a lower average prime interest rate (8.50% vs. 8.76%) related to certain borrowings which are tied to prime and reduced borrowings from the Company's asset based financing lender.

Other income increased \$85,000 or 177%, to \$133,000 from \$48,000 when comparing the nine months ended June 30, 2001 and June 30, 2000, respectively. This significant increase was primarily attributed to the settlement of a Company outstanding debt of \$352,000 for \$270,000. The difference of \$82,000 was recorded as a relief of debt and is included in other income.

Liquidity and Capital Resources

At June 30, 2001, working capital was a negative \$1,842,000 compared with a negative \$2,332,000 as of September 30, 2000. The ratio of current assets to current liabilities was .7 to 1 at June 30, 2001, and .6 to 1 at September 30, 2000. The decrease in the Company's negative working capital was primarily due to an increase in inventory along with the lowering of current debt associated with acquisitions.

The Company has an accumulated deficit of \$7,215,000. Although the Company experienced nominal net income in fiscal years 1997 and 2000 and to date in 2001, past recurring losses and inability to generate sufficient cash flow from normal operations to meet its obligations as they become due, raise substantial doubt about the Company's ability to continue as a going concern. The Company's ability to continue in existence is dependent upon future developments, including retaining current financing and achieving a level of profitable operations sufficient to enable it to meet its obligations as they become due.

Environmental Matters

The Company owns a manufacturing facility located in South El Monte, California. The California Regional Water Quality Control Board (The "RWQCB") ordered the Company in 1988 and 1989 to investigate the contamination on its property (relating to soil and groundwater contamination). The Company engaged a consultant who performed tests and reported to the then Chairman of the Company. The Company resisted further work on its property until the property upgradient was tested in greater detail since two "apparent source" lots had not been tested. On August 12, 1991, the RWQCB issued a "Cleanup and Abatement Order" directing the Company to conduct further testing and cleanup the site. In October 1991, the Company received from an environmental consulting firm an estimate of \$465,200 for investigation and cleanup costs. The Company believed that this estimate was inconclusive and overstated the contamination levels. The Company believes that subsequent investigations will support the Company's conclusions about that estimate. The Company did not complete the testing for the reasons listed above as well as "financial constraints". In June 1992, the RWQCB requested that the EPA evaluate the contamination and take appropriate action. At the EPA's request, Ecology & Environment, Inc. conducted an investigation of soil and groundwater on the Company's property. Ecology & Environment Inc.'s Final Site Assessment Report, which was submitted to the EPA in June 1994, did not rule out the possibility that some of the contamination originated on-site, and resulted from either past or current operations on the property. The Company may be liable for all or part of the costs of remediating the contamination on its property. The EPA has not taken any further action in this matter, but may do so in the future.

The Company and nearby property owners, in consort with their comprehensive general liability (CGL) carriers, engaged a consultant to perform a site investigation with respect to soil and shallow groundwater contamination over the entire city block. The CGL carriers provided \$290,000 in funding which paid for the \$220,000 study, \$20,000 in legal fees for project oversight, and a \$50,000 balance in the operating fund. Earlier the Company had accrued \$87,500 as its proportionate share of the earlier quote of \$175,000. Since that time, the overall scope of the project was increased to \$205,000 plus \$15,000 for waste water disposal, bringing the total to the above listed \$220,000. The \$87,500 accrual was not spent on this project (as the entire cost was borne by the CGL carriers), but remains on the books as an accrual against the cost of remediation of the same site that was included in the study.

The tenants of nearby properties upgradient have sued the Company alleging that hazardous materials from the Company's property caused contamination on the properties leased by the tenants. The case name is Del Ray Industrial Enterprises, Inc. v. Robert Malone, et al., Los Angeles County Superior Court, Northwest District, commenced August 21, 1991. In this action, the plaintiff alleges environmental contamination by defendants of its property, and seeks a court order preventing further contamination and monetary damages. The Company does not believe there is any basis for the allegations and is vigorously defending the lawsuit.

The Company's South El Monte manufacturing facility is also located over a large area of possibly contaminated regional groundwater which is part of the San Gabriel Valley Superfund Site. The Company has been notified that it is a potentially responsible party ("PRP") for the contamination. In 1995, the Company was informed that the EPA estimated the cleanup costs for the South El Monte's portion of the San Gabriel Valley Superfund Site to be \$30 million. The Company's potential share of such amount has not been determined. Superfund PRPs are jointly and severally liable for superfund site costs, and are responsible for negotiating among themselves the allocation of the costs based on, among other things, the outcome of environmental investigation.

In August 1995, the Company was informed that the EPA entered into an Administrative Order of Consent with Cardinal Industrial Finishes ("Cardinal") for a PRP lead remedial investigation and feasibility study (the "Study") which, the EPA states, will both characterize the extent of groundwater contamination in South El Monte and analyze alternatives to control the spread of contamination. The Company and others entered into the South El Monte Operable Unit Site Participation Agreement with Cardinal pursuant to which, among other things, Cardinal contracted with an environmental firm to conduct the Study. The Study has been completed. The Company's share of the cost of the Study was \$15,000 and was accrued for in the financial statements as of September 30, 1995. The South El Monte Operable Unit (SEMOU) participants developed four remedial alternatives. The capital cost of the four alternatives range from \$0 (no action) up to \$3.49 million. The estimated annual operating cost for the four alternatives range from \$0 (no action) to \$770,300. Over a 30-year period, the total cost of the four alternatives range from \$0 (no action) up to \$13.05 million. The EPA prefers an alternative which estimates the capital cost up to \$3.08 million, the annual operating cost at \$.48 million, and the 30-year period total cost up to approximately \$9.09 million. The selection of the actual alternative implemented is subject to public comment. At the present time, the Company does not know what its share of the cost may be, if any. Therefore, no additional accrual has been recognized as a liability on the Company's books. The Company requested that the EPA conduct an "ability-to-pay evaluation" to determine whether the Company is entitled to an early settlement of this matter based upon a limited ability to pay costs associated with site investigation and remediation. In August 2000, the EPA informed the Company that it does not qualify for an early settlement at this time.

The EPA has informed the Company that it has learned that the intermediate zone groundwater contamination in the western portion of the SEMOU has migrated further west and has now impacted the City of Monterey Park and Southern California Water Company production wells. The EPA stated that the City of Monterey Park Water Department, San Gabriel Valley Water Company and Southern California Water Company are planning to build treatment facilities for their wells. The EPA stated that these three water purveyors contacted some of the SEMOU PRPs, other than the Company, to seek funding to develop groundwater treatment facilities for the contaminated wells. A group of these PRPs calling themselves the "South El Monte Cooperative Group" has been formed and purportedly has reached a general agreement with the water purveyors to fund the development of treatment facilities and use the water purveyors' wells in an attempt to contain the groundwater contamination to meet EPA's goals. At this time, the EPA has not reviewed or approved any specific plan to address contamination at the purveyor wells, nor has the EPA compromised its right to recover response costs from any person who is legally responsible for contamination within the SEMOU. As of the date of this report, the Company has not been contacted by the South El Monte Cooperative Group in respect to its participation in any proposed cleanup activity. As a result, the Company is not able to determine what contribution, if any, it may be assessed in connection with this cleanup activity.

By letter dated November 13, 2000, the Company was notified that the City of Monterey Park, San Gabriel Valley Water Company and Southern California Water Company intend to bring suit under the Safe Drinking Water and Toxic Enforcement Act of 1986 alleging that the Company has knowingly released volatile organic compounds in the soil and shallow groundwater beneath the Company's property between at least on or before November 8, 1996 and the present and has failed to promptly clean up all of the contamination. As of the date of this report, the Company has not been served with this lawsuit.

The City of South El Monte, the city in which the Company has its manufacturing facility, is located in the San Gabriel Valley. The San Gabriel Valley has been declared a Superfund site. The 1995 Water Quality Control Plan issued by the California Regional Water Quality Control Board states that the primary groundwater basin pollutants in the San Gabriel Valley are volatile organic compounds from industry, nitrates from subsurface sewage disposal and past agricultural activities. In addition, the Plan noted that hundreds of underground storage tanks leaking gasoline and other toxic chemicals have existed in the San Gabriel Valley. The California Department of Toxic Substance Control has declared large areas of the San Gabriel Valley to be environmentally hazardous and subject to cleanup work.

The Company believes the City of South El Monte does not appear to be located over any of the major plumes. However, the EPA has announced it is studying the possibility that, although the vadose soil and groundwater, while presenting cleanup problems, there may be a

contamination by DNAPs (dense non-aqueous phase liquids), i.e., "sinkers", usually chlorinated organic cleaning solvents. The EPA has proposed to drill six "deep wells" throughout the City of South El Monte at an estimated cost of \$1,400,000. The EPA is conferring with SEMPOA (South El Monte Property Owners Association) as to cost sharing on this project. SEMPOA has obtained much lower preliminary cost estimates. The outcome cost and exact scope of this are unclear at this time.

The Company and other property owners engaged Geomatrix Consultants, Inc., to do a survey of vadose soil and shallow groundwater in the "hot spots" detected in the previous studies. Geomatrix issued a report dated December 1, 1997 (the "Report"), on the impact of volatile organic compounds on the soil and groundwater at the Lidcombe and Santa Anita Avenue site located in South El Monte, California (which includes the Company's facilities). The Report indicated generally low concentrations of tetrachloroethene, trichloroethene and trichloroethane in the groundwater of the upgradient neighbor. The Report was submitted to the RWQCB for its comments and response. A meeting with the parties and RWQCB was held on February 10, 1998. The RWQCB had advised companies that vadose soil contamination is minimal and requires no further action. However, there is an area of shallow groundwater which has a higher than desired level of chlorinated solvents, and the RWQCB requested a proposed work plan be submitted by Geomatrix. Geomatrix has submitted a "Focused Feasibility Study" which concludes that there are five possible methods for cleanup. The most expensive are for a pump and sewer remediation which would cost between \$1,406,000 and \$1,687,000. The Company is actively exploring the less expensive alternative remediation methods, of which the two proposed alternatives range in cost between \$985,000 and \$1,284,000. Since there are four economic entities involved, the Company's best estimate at this time, in their judgment, would be that their forecasted share would be \$287,000 less the liability already recognized on the books of \$165,000 thereby requiring an additional \$122,000 liability. Accordingly, the Company recorded an additional accrual of \$122,000 in the third quarter of fiscal 1998. The \$122,000 accrual is in addition to the \$79,000 accrual for the Monterey Site as will be explained in the following paragraph. The \$79,000 accrual, in the third quarter of fiscal 1998, related to the Monterey Site is not included in the \$287,000 figure above. In April 2000, the Company received a Notice of Violation from the RWQCB. The Notice of Violation states that the Company and other property owners were required to submit a groundwater remedial action plan by November 1, 1999, and that the RWQCB has been advised that the Company and the other property owners were unable to submit the required remedial action plan because the Company and the other property owners could not agree on the allocation of financial responsibility to prepare the action plan. The RWQCB stated that it will no longer encourage the cooperative approach among the Company and the other property owners in completing the cleanup requirements and will pursue appropriate measures, including when necessary, enforcement actions. The RWQCB states that it may impose civil liability penalties of up to \$1,000 per day from November 1, 1999 for failure to file the action plan. In light of these events, no assurances can be given that the cleanup costs and possible penalties will not exceed the amount of the Company's current accruals of \$287,000 (which includes the \$122,000 charge to income in the third quarter of fiscal 1998).

In July 2000, the property owners formed the Lidcombe & Santa Anita Avenue Work Group (LSAAW) in response to the RWQCB request for the preparation of an action plan. The LSAAW submitted a Focused Feasibility Study to the RWQCB for their review and approval of the selected remedial action method for the site. After receiving RWQCB approval, LSAAW obtained three cost proposals to implement the RWQCB approved pump and treat remedial method. According to these cost proposals, the lowest estimated costs for an assumed five (5) years of pump and treat remediation is \$600,000. This cost is lower than the previous cost proposed work plan, discussed above, from Geomatrix Consultants, Inc. The capital costs including contingencies are approximately \$300,000.

The LSAAW is hopeful the Water Quality Authority (WQA) is willing and able to reauthorize its grant for one-half (1/2) of the capital costs of its remediation system construction not to exceed \$150,000. It is estimated at this time that the reserves for the Company's share of this cost proposal are adequate since its prior accrual was based on the higher cost estimate from Geomatrix.

Without any prior correspondence or inkling of the Company's potential liability, the EPA informed the Company that the Company may have potential liability for the ongoing remediation of Operating Industries, Inc. (as they have gone out of business) Landfill Superfund Site in Monterey Park, California (the "Monterey Site"). The Monterey Site is a 190 acre landfill that operated from 1948 to 1984, in which the Company disposed of non toxic pH balanced waste water on six occasions between 1974 and 1978. Over 4,000 companies have been identified as having contributed waste to the Monterey Site. The EPA has offered to settle the Company's potential liability with respect to the Monterey Site for a cost to the Company of \$79,233. The Company accrued a \$79,000 charge in the third quarter of fiscal 1998 with respect to this possible liability. The Company has elected to file for relief from these obligations under the financial hardship option in the EPA's response form. On June 30, 2000, the EPA informed the Company that the EPA believed the Company is able to pay the full settlement cost, but offered to reduce the amount of the settlement to \$75,271. The Company is in the process of responding to this letter.

The Company was notified by the EPA that the Company may have potential liability for waste material it disposed of at the Casmalia Disposal Site ("Site") located on a 252-acre parcel in Santa Barbara County, California. The Site was operational from 1973 to 1989, and over 10,000 separate parties disposed of waste there. The EPA stated that federal, state and local governmental agencies along with the numerous private entities that used the Site for waste disposal will be expected to pay their share as part of this settlement. The U.S. EPA is also pursuing the owner(s)/operator(s) of the Site to pay for Site remediation. The EPA has a settlement offer to the Company with respect to the Site for a cost of \$373,950. The Company accrued a \$374,000 charge in the first quarter of fiscal 1999 with respect to this possible liability. The Company has elected to file for relief from these obligations under the financial hardships option in the EPA's response form. The Company, the EPA and certain PRPs have entered into an agreement tolling the applicable statutes of limitation. The Company was recently notified by the EPA that their request for a waiver, due to financial hardship, was "partially granted." Improvements in the bidding process has lowered the Company's estimated share down to \$245,000 (from \$374,000) and of that, the EPA was requesting that the Company pay \$113,000, as a result of their findings on the application for waiver due to financial hardship. The Company is considering the EPA's request.

The total amount of environmental investigation and cleanup costs that the Company may incur with respect to the foregoing is not known at this time. However, based upon information available to the Company at this time, the Company has expensed since 1988 a total of \$860,000, of which \$89,000 were legal fees, exclusive of legal fees expended in connection with the SEC environmental investigation. The actual costs could differ materially from the amounts expensed for environmental investigation and cleanup costs to date.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth under Part I, Item 2, "Management's Discussion and Analysis or Plan of Operations - Environmental Matters" is incorporated herein by reference. See also "Legal Proceedings" in the Company's Form 10-KSB for the fiscal year ended September 30, 2000.

Item 6. The following exhibits are filed herewith:

- 10.1 - Promissory note evidencing advance made to the Registrant
- 10.2 - Sublease dated April 17, 2001, for the premises located at 1470 Santa Anita Avenue, So. El Monte, California

The following exhibits have previously been filed by the Company:

- 3.1 - Articles of Incorporation, as amended (1)
- 3.4 - By-laws, as amended December 20, 1997 (2)
- 3.5 - Amendment of By-laws effective March 14, 1978 (2)
- 3.6 - Amendment to By-laws effective November 1, 1980 (3)

- (1) Filed as an Exhibit of the same number with the Company's Form S-1 Registration Statement filed with the Securities and Exchange Commission on February 5, 1973, (Registrant No. 2-47005), and incorporated herein by reference.

- (2) Filed as Exhibits 3.4 and 3.5 with the Company's Form 10-K Annual Report for the fiscal year ended September 30, 1978, filed with the Securities and Exchange Commission and incorporated herein by reference.
- (3) Filed as an Exhibit of the same number with the Company's Form 10-K Annual Report for the fiscal year ended September 30, 1979, filed with the Securities and Exchange Commission and incorporated herein by reference.

SIGNATURE

In accordance with the requirements of the Securities Exchange Acts of 1934, the registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LEE PHARMACEUTICALS

(Registrant)

Date: August 2, 2001

RONALD G. LEE

Ronald G. Lee
Chairman of the Board, President and
Chief Financial and Accounting Officer

PROMISSORY NOTE\$200,000

South El Monte, California

June 27, 2001

For value received, Lee Pharmaceuticals promises to pay Roberts Proprietaries Inc. or order, at South El Monte, California the sum of TWO HUNDRED THOUSAND DOLLARS, with interest from June 27, 2001, on unpaid principal at the rate of twenty (20) per cent per annum; principal is payable monthly, commencing on August 1, 2001, with monthly principal payments in the amount of \$5,000, plus interest. Interest shall be calculated on the basis of the unpaid principal balance daily, based on a 365-day year, actual day month, payable monthly. Final payment of \$5,000 plus interest will be due on November 1, 2004. Principal and interest shall be payable in lawful money of the United States. If action were instituted on this note, I promise to pay such sum as the Court may fix as attorney's fees. This note is secured by the trademark on the product brand Zip[®].

This promissory note replaces the \$500,000 promissory note, dated December 1, 1998, which has been paid down to \$80,000 as of June 1, 2001. All other terms and conditions (including the Security Agreement, Amendment No. 1 to 1988 Security Agreement, Guarantee of Ronald G. Lee and Exhibits) of the December 1, 1998, \$500,000 promissory note, remain in force except as stated in the above paragraph of this new promissory note, dated June 27, 2001.

June 21, 2001

Date

RONALD G. LEE

Lee Pharmaceuticals - Ronald G. Lee

AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION

STANDARD SUBLEASE

(Long-form to be used with pre-1996 AIR leases)

1. **Parties.** This Sublease, dated, for reference purposes only, April 17, 2001, is made by and between Lee Pharmaceuticals, a California corporation ("Sublessor") and Bi-Tank, Inc., a California corporation ("Sublessee").

2. **Premises.** Sublessor hereby subleases to Sublessee and Sublessee hereby subleases from Sublessor for the term, at the rental, and upon all of the conditions set forth herein, that certain real property, including all improvements therein, and commonly known by the street address of 1470 Santa Anita Avenue, South El Monte located in the County of Los Angeles, State of California 91733 and generally described as (describe briefly the nature of the property) a one-story building of approximately 8,400 square feet ("Premises").

3. **Term.**

3.1 **Term.** The term of this Sublease shall be for four (4) years and eight (8) months commencing on April 1, 2001 and ending on November 30, 2005 unless sooner terminated pursuant to any provision hereof.

3.2 **Delay in Commencement.** Sublessor agrees to use its best commercially reasonable efforts to deliver possession of the Premises by the commencement date. If, despite said efforts, Sublessor is unable to deliver possession as agreed, Sublessor shall not be subject to any liability therefor, nor shall such failure affect the validity of this Sublease. Sublessee shall not, however, be obligated to pay Rent or perform its other obligations until it receives possession of the Premises. If possession is not delivered within sixty days after the commencement date, Sublessee may, at its option, by notice in writing within ten days after the end of such sixty day period, cancel this Sublease, in which event the Parties shall be discharged from all obligations hereunder. If such written notice is not received by Sublessor within said ten day period, Sublessee's right to cancel shall terminate. Except as otherwise provided, if possession is not tendered to Sublessee when required and Sublessee does not terminate this Sublease, as aforesaid, any period of rent abatement that Sublessee would otherwise have enjoyed shall run from the date of delivery of possession and continue for a period equal to what Sublessee would otherwise have enjoyed under the terms hereof, but minus any days of delay caused by the acts or omissions of Sublessee. If possession is not delivered within 120 days after the commencement date, this Sublease shall automatically terminate unless the Parties agree, in writing, to the contrary.

4. **Rent.**

4.1 **Base Rent.** Sublessee shall pay to Sublessor as Base Rent for the Premises equal monthly payments of \$ None
See Paragraph 12.b.

4.2 **Rent Defined.** All monetary obligations of Sublessee to Sublessor under the terms of this Sublease (except for the Security Deposit) are deemed to be rent ("**Rent**"). Rent shall be payable in lawful money of the United States to Sublessor at the address stated herein or to such other persons or at such other places as Sublessor may designate in writing.

6. **Use.**

6.1 **Agreed Use.** The Premises shall be used and occupied only for warehouse and distribution of bicycles only and for no other purpose.

6.2 **Compliance.** Sublessor warrants that the improvements on the Premises comply with all applicable covenants or restrictions of record and applicable building codes, regulations and ordinances ("**Applicable Requirements**") in effect on the commencement date. Said warranty does not apply to the use to which Sublessee will put the Premises or to any alterations or utility installations made or to be made by Sublessee. NOTE: Sublessee is responsible for determining whether or not the zoning is appropriate for its intended use, and acknowledges that past uses of the Premises may no longer be allowed. If the Premises do not comply with said warranty, Sublessor shall, except as otherwise provided, promptly after receipt of written notice from Sublessee setting forth with specificity the nature and extent of such non-compliance, rectify the same at Sublessor's expense. If Sublessee does not give Sublessor written notice of a non-compliance with this warranty within six months following the commencement date, correction of that non-compliance shall be the obligation of Sublessee at its sole cost and expense. If the Applicable Requirements are hereafter changed so as to require during the term of this Sublease the construction of an addition to or an alteration of the Building, the remediation of any Hazardous Substance, or the reinforcement or other physical modification of the Building ("**Capital Expenditure**"), Sublessor and Sublessee shall allocate the cost of such work as follows:

- (a) If such Capital Expenditures are required as a result of the specific and unique use of the Premises by Sublessee as

compared with uses by tenants in general, Sublessee shall be fully responsible for the cost thereof provided, however, that if such Capital Expenditure is required during the last two years of this Sublease and the cost thereof exceeds six months' Base Rent, Sublessee may instead terminate this Sublease unless Sublessor notifies Sublessee in writing, within ten days after receipt of Sublessee's termination notice that Sublessor has elected to pay the difference between the actual cost thereof and the amount equal to six months' Base Rent. If the Parties elect termination, Sublessee shall immediately cease the use of the Premises which requires such Capital Expenditure and deliver to Sublessor written notice specifying a termination date at least ninety days thereafter. Such termination date shall, however, in no event be earlier than the last day that Sublessee could legally utilize the Premises without commencing such Capital Expenditure.

(b) If such Capital Expenditure is not the result of the specific and unique use of the Premises by Sublessee (such as governmentally mandated seismic modifications, then Sublessor shall pay for said Capital Expenditure and the cost thereof shall be prorated between the Sublessor and Sublessee and Sublessee shall only be obligated to pay, each month during the remainder of the term of this Sublease, on the date on which Rent is due, an amount equal to the product of multiplying the cost of such Capital Expenditure by a fraction, the numerator of which is one, and the denominator of which is the number of months of the useful life of such Capital Expenditure as such useful life is specified pursuant to Federal income tax regulations or guidelines for depreciation thereof (including interest on the unamortized balance as is then commercially reasonable in the judgment of Sublessor's accountant), with Sublessee reserving the right to prepay its obligation at any time. Provided, however, that if such Capital Expenditure is required during the last two years of this Sublease or if Sublessor reasonably determines that it is not economically feasible to pay its share thereof, Sublessor shall have the option to terminate this Sublease upon ninety days prior written notice to Sublessee unless Sublessee notifies Sublessor, in writing, within ten days after receipt of Sublessor's termination notice that Sublessee will pay for such Capital Expenditure. If Sublessor does not elect to terminate, and fails to tender its share of any such Capital Expenditure, Sublessee may advance such funds and deduct same, with interest, from Rent until Sublessor's share of such costs have been fully paid. If Sublessee is unable to finance Sublessor's share, or if the balance of the Rent due and payable for the remainder of this Sublease is not sufficient to fully reimburse Sublessee on an offset basis, Sublessee shall have the right to terminate this Sublease upon ten days written notice to Sublessor.

(c) Notwithstanding the above, the provisions concerning Capital Expenditures are intended to apply only to non-voluntary, unexpected, and new Applicable Requirements. If the Capital Expenditures are instead triggered by Sublessee as a result of an actual or proposed change in use, change in intensity of use, or modification to the Premises then, and in that event, Sublessee shall be fully responsible for the cost thereof, and Sublessee shall not have any right to terminate this Sublease.

6.3 Acceptance of Premises and Lessee. Sublessee acknowledges that:

(a) it has been advised by Brokers to satisfy itself with respect to the condition of the Premises (including but not limited to the electrical, HVAC and fire sprinkler systems, security, environmental aspects, and compliance with Applicable Requirements), and their suitability for Sublessee's intended use,

(b) Sublessee has made such investigation as it deems necessary with reference to such matters and assumes all responsibility therefor as the same relate to its occupancy of the Premises, and

(c) neither Sublessor, Sublessor's agents, nor any Broker has made any oral or written representations or warranties with respect to said matters other than as set forth in this Sublease.

In addition, Sublessor acknowledges that:

(a) Broker has made no representations, promises or warranties concerning Sublessee's ability to honor the Sublease or suitability to occupy the Premises, and

(b) it is Sublessor's sole responsibility to investigate the financial capability and/or suitability of all proposed tenants.

7. Master Lease

7.1 Sublessor is the lessee of the Premises by virtue of a lease, hereinafter the "**Master Lease**", a copy of which is attached hereto marked Exhibit 1, wherein Lee Pharmaceuticals leased from Art Weiss, Lessor, the building, Lease is dated April 16, 1990. Also, Amendment No. 1 to 1470 Santa Anita Lease. is the lessor, hereinafter the "**Master Lessor**"

7.2 This Sublease is and shall be at all times subject and subordinate to the Master Lease.

7.3 The terms, conditions and respective obligations of Sublessor and Sublessee to each other under this Sublease shall be the terms and conditions of the Master Lease except for those provisions of the Master Lease which are directly contradicted by this Sublease in which event the terms of this Sublease document shall control over the Master Lease. Therefore, for the purposes of this Sublease, wherever in the Master Lease the word "Lessor" is used it shall be deemed to mean the Sublessor herein and wherever in the Master Lease the word "Lessee" is used it shall be deemed to mean the Sublessee herein.

7.4 During the term of this Sublease and for all periods subsequent for obligations which have arisen prior to the termination of this Sublease, Sublessee does hereby expressly assume and agree to perform and comply with, for the benefit of Sublessor and

Master Lessor, each and every obligation of Sublessor under the Master Lease except for the following paragraphs which are excluded therefrom:

7.5 The obligations that Sublessee has assumed under paragraph 7.4 hereof are hereinafter referred to as the **"Sublessee's Assumed Obligations"**. The obligations that Sublessee has not assumed under paragraph 7.4 hereof are hereinafter referred to as the **"Sublessor's Remaining Obligations"**.

7.6 Sublessee shall hold Sublessor free and harmless from all liability, judgments, costs, damages, claims or demands, including reasonable attorneys fees, arising out of Sublessee's failure to comply with or perform Sublessee's Assumed Obligations.

7.7 Sublessor agrees to maintain the Master Lease during the entire term of this Sublease, subject, however, to any earlier termination of the Master Lease without the fault of the Sublessor, and to comply with or perform Sublessor's Remaining Obligations and to hold Sublessee free and harmless from all liability, judgments, costs, damages, claims or demands arising out of Sublessor's failure to comply with or perform Sublessor's Remaining Obligations.

7.8 Sublessor represents to Sublessee that the Master Lease is in full force and effect and that no default exists on the part of any Party to the Master Lease.

8. Assignment of Sublease and Default.

8.1 Sublessor hereby assigns and transfers to Master Lessor the Sublessor's interest in this Sublease, subject however to the provisions of Paragraph 8.2 hereof.

8.2 Master Lessor, by executing this document, agrees that until a Default shall occur in the performance of Sublessor's Obligations under the Master Lease, that Sublessor may receive, collect and enjoy the Rent accruing under this Sublease. However, if Sublessor shall Default in the performance of its obligations to Master Lessor then Master Lessor may, at its option, receive and collect, directly from Sublessee, all Rent owing and to be owed under this Sublease. Master Lessor shall not, by reason of this assignment of the Sublease nor by reason of the collection of the Rent from the Sublessee, be deemed liable to Sublessee for any failure of the Sublessor to perform and comply with Sublessor's Remaining Obligations.

8.3 Sublessor hereby irrevocably authorizes and directs Sublessee upon receipt of any written notice from the Master Lessor stating that a Default exists in the performance of Sublessor's obligations under the Master Lease, to pay to Master Lessor the Rent due and to become due under the Sublease. Sublessor agrees that Sublessee shall have the right to rely upon any such statement and request from Master Lessor, and that Sublessee shall pay such Rent to Master Lessor without any obligation or right to inquire as to whether such Default exists and notwithstanding any notice from or claim from Sublessor to the contrary and Sublessor shall have no right or claim against Sublessee for any such Rent so paid by Sublessee.

8.4 No changes or modifications shall be made to this Sublease without the consent of Master Lessor.

9. Consent of Master Lessor.

9.1 In the event that the Master Lease requires that Sublessor obtain the consent of Master Lessor to any subletting by Sublessor then, this Sublease shall not be effective unless, within ten days of the date hereof, Master Lessor signs this Sublease thereby giving its consent to this Subletting.

9.2 In the event that the obligations of the Sublessor under the Master Lease have been guaranteed by third parties then neither this Sublease, nor the Master Lessor's consent, shall be effective unless, within 10 days of the date hereof, said guarantors sign this Sublease thereby giving their consent to this Sublease.

9.3 In the event that Master Lessor does give such consent then:

(a) Such consent shall not release Sublessor of its obligations or alter the primary liability of Sublessor to pay the Rent and perform and comply with all of the obligations of Sublessor to be performed under the Master Lease.

(b) The acceptance of Rent by Master Lessor from Sublessee or anyone else liable under the Master Lease shall not be deemed a waiver by Master Lessor of any provisions of the Master Lease.

(c) The consent to this Sublease shall not constitute a consent to any subsequent subletting or assignment.

(d) In the event of any Default of Sublessor under the Master Lease, Master Lessor may proceed directly against Sublessor, any guarantors or anyone else liable under the Master Lease or this Sublease without first exhausting Master Lessor's remedies against any other person or entity liable thereon to Master Lessor.

(e) Master Lessor may consent to subsequent sublettings and assignments of the Master Lease or this Sublease or any

amendments or modifications thereto without notifying Sublessor or anyone else liable under the Master Lease and without obtaining their consent and such action shall not relieve such persons from liability.

(f) In the event that Sublessor shall Default in its obligations under the Master Lease, then Master Lessor, at its option and without being obligated to do so, may require Sublessee to attorn to Master Lessor in which event Master Lessor shall undertake the obligations of Sublessor under this Sublease from the time of the exercise of said option to termination of this Sublease but Master Lessor shall not be liable for any prepaid Rent nor any Security Deposit paid by Sublessee, nor shall Master Lessor be liable for any other Defaults of the Sublessor under the Sublease.

9.4 The signatures of the Master Lessor and any Guarantors of Sublessor at the end of this document shall constitute their consent to the terms of this Sublease.

9.5 Master Lessor acknowledges that, to the best of Master Lessor's knowledge, no Default presently exists under the Master Lease of obligations to be performed by Sublessor and that the Master Lease is in full force and effect.

9.6 In the event that Sublessor Defaults under its obligations to be performed under the Master Lease by Sublessor, Master Lessor agrees to deliver to Sublessee a copy of any such notice of default. Sublessee shall have the right to cure any Default of Sublessor described in any notice of default within ten days after service of such notice of default on Sublessee. If such Default is cured by Sublessee then Sublessee shall have the right of reimbursement and offset from and against Sublessor.

10. **Brokers Fee.**

10.1 Upon execution hereof by all parties, Sublessor shall pay to No Broker a licensed real estate broker, ("**Broker**"), a fee as set forth in a separate agreement between Sublessor and Broker, or in the event there is no such separate agreement, the sum of \$ None for brokerage services rendered by Broker to Sublessor in this transaction.

10.2 Sublessor agrees that if Sublessee exercises any option or right of first refusal as granted by Sublessor herein, or any option or right substantially similar thereto, either to extend the term of this Sublease, to renew this Sublease, to purchase the Premises, or to lease or purchase adjacent property which Sublessor may own or in which Sublessor has an interest, then Sublessor shall pay to Broker a fee in accordance with the schedule of Broker in effect at the time of the execution of this Sublease. Notwithstanding the foregoing, Sublessor's obligation under this Paragraph 10.2 is limited to a transaction in which Sublessor is acting as a Sublessor, lessor or seller.

10.3 Master Lessor agrees that if Sublessee shall exercise any option or right of first refusal granted to Sublessee by Master Lessor in connection with this Sublease, or any option or right substantially similar thereto, either to extend or renew the Master Lease, to purchase the Premises or any part thereof, or to lease or purchase adjacent property which Master Lessor may own or in which Master Lessor has an interest, or if Broker is the procuring cause of any other lease or sale entered into between Sublessee and Master Lessor pertaining to the Premises, any part thereof, or any adjacent property which Master Lessor owns or in which it has an interest, then as to any of said transactions, Master Lessor shall pay to Broker a fee, in cash, in accordance with the schedule of Broker in effect at the time of the execution of this Sublease.

10.4 Any fee due from Sublessor or Master Lessor hereunder shall be due and payable upon the exercise of any option to extend or renew, upon the execution of any new lease, or, in the event of a purchase, at the close of escrow.

10.5 Any transferee of Sublessor's interest in this Sublease, or of Master Lessor's interest in the Master Lease, by accepting an assignment thereof, shall be deemed to have assumed the respective obligations of Sublessor or Master Lessor under this Paragraph 10. Broker shall be deemed to be a third-party beneficiary of this paragraph 10.

11. **Attorney's Fees.** If any party or the Broker named herein brings an action to enforce the terms hereof or to declare rights hereunder, the prevailing party in any such action, on trial and appeal, shall be entitled to his reasonable attorney's fees to be paid by the losing party as fixed by the Court.

12. **Additional Provisions.** [If there are no additional provisions, draw a line from this point to the next printed word after the space left here. If there are additional provisions place the same here. 12.a. INSURANCE: Sublessee shall obtain a policy of general commercial liability insurance as required in the Master Lease, naming Art Weiss and Lee Pharmaceuticals, Inc. as additional insured.
12.b. RENT: All terms and conditions of the sublease agreement, including payment of rent, shall be the responsibility jointly of Steady Star, Inc. and Bi-Tank, Inc.
12.c. Sublessee agrees to accept the Premises "as is". Any repairs, alterations or modifications are to be at the sole cost of Sublessee.

ATTENTION: NO REPRESENTATION OR RECOMMENDATION IS MADE BY THE AMERICAN INDUSTRIAL REAL ESTATE ASSOCIATION OR BY ANY REAL ESTATE BROKER AS TO THE LEGAL SUFFICIENCY,

LEGAL EFFECT, OR TAX CONSEQUENCES OF THIS SUBLEASE OR THE TRANSACTION TO WHICH IT RELATES. THE PARTIES ARE URGED TO:

- 1. SEEK ADVICE OF COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS SUBLEASE.**
- 2. RETAIN APPROPRIATE CONSULTANTS TO REVIEW AND INVESTIGATE THE CONDITION OF THE PREMISES. SAID INVESTIGATION SHOULD INCLUDE BUT NOT BE LIMITED TO: THE POSSIBLE PRESENCE OF HAZARDOUS SUBSTANCES, THE ZONING OF THE PROPERTY, THE STRUCTURAL INTEGRITY, THE CONDITION OF THE ROOF AND OPERATING SYSTEMS, AND THE SUITABILITY OF THE PREMISES FOR SUBLESSEE'S INTENDED USE.**

WARNING: IF THE SUBJECT PROPERTY IS LOCATED IN A STATE OTHER THAN CALIFORNIA, CERTAIN PROVISIONS OF THE SUBLEASE MAY NEED TO BE REVISED TO COMPLY WITH THE LAWS OF THE STATE IN WHICH THE PROPERTY IS LOCATED.

Executed at:	<u>South El Monte</u>	<u>Lee Pharmaceuticals</u>
on:	<u>04/24/01</u>	<u>By /s/ Ronald G. Lee</u>
		<u>Ronald G. Lee</u>
Address:	<u>1434 Santa Anita Avenue</u>	<u>By</u>
	<u>So. El Monte, CA 91733</u>	<u>"Sublessor" (Corporate Seal)</u>

Executed at:	<u>South EL Monte</u>	<u>Bi-Tank, Inc.</u>
on:	<u>4/27/01</u>	<u>By /s/ Long Jing Jing</u>
		<u>Jing Jing Long</u>
Address:	<u>1470 Santa Anita Ave</u>	<u>By</u>
	<u>S. EL Monte, CA 91733</u>	<u>"Sublessee" (Corporate Seal)</u>

Executed at:	<u>South El Monte</u>	<u>Art Weiss</u>
on:	<u>4-24-2001</u>	<u>By /s/ Art Weiss</u>
		<u>Art Weiss</u>
Address:	<u>10616 Rush Street</u>	<u>By</u>
	<u>South El Monte CA 91733-3432</u>	<u>"Master Lessor" (Corporate Seal)</u>

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, 700 So. Flower St., Suite 600, Los Angeles, CA 90017. (213) 687-8777.