

Edgar Filing: MACE SECURITY INTERNATIONAL INC - Form 10-Q

MACE SECURITY INTERNATIONAL INC  
Form 10-Q  
November 12, 2002

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15 (D)  
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED SEPTEMBER 30, 2002                      COMMISSION FILE NO. 0-22810

MACE SECURITY INTERNATIONAL, INC.  
(Exact name of Registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of incorporation or organization)

03-0311630  
(I.R.S. Employer Identification No.)

1000 Crawford Place, Suite 400, Mt. Laurel, NJ 08054  
(Address of Principal Executive Offices)

Registrant's Telephone No., including area code: (856) 778-2300

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such report), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock:

As of November 7, 2002, there were 24,921,685 Shares of Registrant's Common Stock, par value \$.01 per share, outstanding.

Mace Security International, Inc.

Form 10-Q  
Quarter Ended September 30, 2002

Contents

PART I - FINANCIAL INFORMATION

Item 1 - Financial Statements

Consolidated Balance Sheets - September 30, 2002 (Unaudited)  
and December 31, 2001

Page

2

2

# Edgar Filing: MACE SECURITY INTERNATIONAL INC - Form 10-Q

|  |    |
|--|----|
| Consolidated Statements of Operations for the three months ended September 30, 2002 and 2001 (Unaudited) | 4  |
| Consolidated Statements of Operations for the nine months ended September 30, 2002 and 2001 (Unaudited)  | 5  |
| Consolidated Statement of Stockholders' Equity for the nine months ended September 30, 2002 (Unaudited)  | 6  |
| Consolidated Statements of Cash Flows for the nine months ended September 30, 2002 and 2001 (Unaudited)  | 7  |
| Notes to Consolidated Financial Statements (Unaudited)   | 8  |
| Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations           | 15 |
| Item 3 - Quantitative and Qualitative Disclosures about Market Risk                                      | 27 |
| Item 4 - Controls and Procedures   | 27 |
| PART II - OTHER INFORMATION  |    |
| Item 1 - Legal Proceedings   | 27 |
| Item 2 - Not applicable  | -  |
| Item 3 - Not applicable  | -  |
| Item 4 - Submission of Matters to a Vote of Security Holders   | 28 |
| Item 5 - Other Information   | 28 |
| Item 6 - Exhibits and Reports on Form 8-K  | 28 |
| Signatures   | 29 |
| Certifications   | 30 |

1

## PART I FINANCIAL INFORMATION

### Item 1. Financial Statements

Mace Security International, Inc.

Consolidated Balance Sheets

(In thousands except share information)

ASSETS

September 30,  
2002

-----  
(Unaudited)

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|   |    |         |
|---|----|---------|
| Current assets:   |    |         |
| Cash and cash equivalents   | \$ | 7,214   |
| Accounts receivable, less allowance for doubtful<br>accounts of \$249 and \$178 in 2002 and 2001, respectively    |    | 922     |
| Inventories   |    | 2,368   |
| Deferred income taxes   |    | 158     |
| Prepaid expenses and other current assets   |    | 2,189   |
|   |    | -----   |
| Total current assets  |    | 12,851  |
| Property and equipment:   |    |         |
| Land  |    | 32,029  |
| Buildings and leasehold improvements  |    | 35,828  |
| Machinery and equipment   |    | 9,292   |
| Furniture and fixtures  |    | 444     |
|   |    | -----   |
| Total property and equipment  |    | 77,593  |
| Accumulated depreciation and amortization   |    | (8,593) |
|   |    | -----   |
| Total property and equipment, net of accumulated depreciation<br>and amortization                                 |    | 69,000  |
| Goodwill  |    | 13,430  |
| Other intangible assets, net of accumulated amortization<br>of \$1,403 and \$1,384 in 2002 and 2001, respectively |    | 963     |
| Deferred income taxes   |    | 1,118   |
| Other assets  |    | 275     |
|   |    | -----   |
| Total assets  | \$ | 97,637  |
|   |    | =====   |

See accompanying notes.

2

|   | September 30,<br>2002 | December 31,<br>2001 |
|---|-----------------------|----------------------|
|   | -----                 | -----                |
|   | (Unaudited)           |                      |
| LIABILITIES AND STOCKHOLDERS' EQUITY                            |                       |                      |
| Current liabilities:  |                       |                      |
| Current portion of long-term debt and capital lease obligations | \$                    | 7,594                |
| Accounts payable  |                       | 2,043                |
| Income taxes payable  |                       | 88                   |
| Deferred revenue  |                       | 223                  |
| Accrued expenses and other current liabilities                  |                       | 2,720                |
|   |                       | -----                |
| Total current liabilities                                       |                       | 12,668               |
| Deferred income taxes   |                       | -                    |
| Long-term debt, net of current portion                          |                       | 25,553               |
| Capital lease obligations, net of current portion               |                       | 348                  |

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|   |    |          |       |
|---|----|----------|-------|
| Other liabilities   |    | 88       |       |
| Stockholders' equity:   |    |          |       |
| Preferred stock, \$.01 par value:   |    |          |       |
| Authorized shares - 10,000,000  |    |          |       |
| Issued and outstanding shares - none  |    | -        |       |
| Common stock, \$.01 par value:  |    |          |       |
| Authorized shares - 100,000,000   |    |          |       |
| Issued and outstanding shares of 25,355,685 and 25,428,427 in 2002 and 2001, respectively |    | 254      |       |
| Additional paid-in capital  |    | 69,902   |       |
| Accumulated deficit   |    | (11,176) |       |
|   |    | -----    | ----- |
| Total stockholders' equity  |    | 58,980   |       |
|   |    | -----    | ----- |
| Total liabilities and stockholders' equity  | \$ | 97,637   | \$    |
|   |    | =====    | ===== |

See accompanying notes.

3

Mace Security International, Inc.

Consolidated Statements of Operations  
(Unaudited)

(In thousands except share information)

|  | Three Months Ended<br>September 30, |       |
|--|-------------------------------------|-------|
|  | 2002                                | 2001  |
|  | -----                               | ----- |
| Revenues:                                    |                                     |       |
| Car wash and detailing services              | \$ 8,707                            | \$ 8, |
| Lube and other automotive services           | 1,125                               | 1,    |
| Fuel and merchandise sales                   | 839                                 |       |
| Security products sales                      | 1,169                               |       |
| Operating agreements                         | -                                   |       |
|  | -----                               | ----- |
|  | 11,840                              | 10,   |
| Cost of revenues:                            |                                     |       |
| Car wash and detailing services              | 6,433                               | 6,    |
| Lube and other automotive services           | 887                                 |       |
| Fuel and merchandise sales                   | 731                                 |       |
| Security products sales                      | 643                                 |       |
|  | -----                               | ----- |
|  | 8,694                               | 8,    |
| Selling, general and administrative expenses | 2,325                               | 1,    |
| Depreciation and amortization                | 474                                 |       |
| Costs of terminated acquisitions             | 57                                  |       |
|  | -----                               | ----- |

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|                                      |            |         |
|--------------------------------------|------------|---------|
| Operating income                     | 290        |         |
| Interest expense, net                | (553)      |         |
| Other income                         | 82         |         |
|                                      | -----      | -----   |
| Loss before income taxes             | (181)      |         |
| Income tax benefit                   | (65)       |         |
|                                      | -----      | -----   |
| Net loss                             | \$ (116)   | \$      |
|                                      | =====      | =====   |
| Per share of common stock:           |            |         |
| Basic                                | \$ -       | \$      |
|                                      | =====      | =====   |
| Diluted                              | \$ -       | \$      |
|                                      | =====      | =====   |
| Weighted average shares outstanding: |            |         |
| Basic                                | 25,353,136 | 25,428, |
| Diluted                              | 25,353,136 | 25,428, |

See accompanying notes.

4

Mace Security International, Inc.

Consolidated Statements of Operations  
(Unaudited)

(In thousands except share information)

|                                    |    |             |
|------------------------------------|----|-------------|
|                                    |    | Nine<br>Sep |
|                                    |    | -----       |
|                                    |    | 2002        |
|                                    |    | -----       |
| Revenues:                          |    |             |
| Car wash and detailing services    | \$ | 28,229      |
| Lube and other automotive services |    | 3,168       |
| Fuel and merchandise sales         |    | 2,407       |
| Security products sales            |    | 1,566       |
| Operating agreements               |    | 80          |
|                                    |    | -----       |
|                                    |    | 35,450      |
| Cost of revenues:                  |    |             |
| Car wash and detailing services    |    | 19,419      |
| Lube and other automotive services |    | 2,509       |
| Fuel and merchandise sales         |    | 2,086       |
| Security products sales            |    | 868         |
|                                    |    | -----       |
|                                    |    | 24,882      |

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|   |            |
|---|------------|
| Selling, general and administrative expenses  | 6,160      |
| Depreciation and amortization   | 1,456      |
| Cost of terminated acquisitions   | 57         |
|   | -----      |
| Operating income  | 2,895      |
| Interest expense, net   | (1,669)    |
| Other income  | 230        |
|   | -----      |
| Income before income taxes and cumulative effect of a change<br>in accounting principle | 1,456      |
| Income tax expense  | 524        |
|   | -----      |
| Income before cumulative effect of a change in accounting principle                     | 932        |
| Cumulative effect of a change in accounting principle, net of tax of \$2,188            | (5,733)    |
|   | -----      |
| Net (loss) income   | \$ (4,801) |
|   | =====      |
| Per share of common stock:  |            |
| Basic income before cumulative effect of a change<br>in accounting principle            | \$ 0.04    |
| Cumulative effect of a change in accounting principle, net of tax                       | \$ (0.23)  |
|   | -----      |
| Basic net (loss) income   | \$ (0.19)  |
|   | =====      |
| Diluted income before cumulative effect of a change<br>in accounting principle          | \$ 0.04    |
| Cumulative effect of a change in accounting principle, net of tax                       | \$ (0.23)  |
|   | -----      |
| Diluted net (loss) income   | \$ (0.19)  |
|   | =====      |
| Weighted average shares outstanding:  |            |
| Basic   | 25,362,849 |
| Diluted   | 25,416,951 |

See accompanying notes.

5

Mace Security International, Inc.

Consolidated Statement of Stockholders' Equity  
(Unaudited)

(In thousands except share information)

Number of Par Value Additional

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|                                     | Common<br>Shares | of Common<br>Stock | Paid-in<br>Capital | Accumulated<br>Deficit |       |
|-------------------------------------|------------------|--------------------|--------------------|------------------------|-------|
|                                     | -----            | -----              | -----              | -----                  | ----- |
| Balance at December 31, 2001 .....  | 25,428,427       | \$ 254             | \$ 69,977          | \$ (6,375)             | \$    |
| Shares issued in acquisition .....  | 13,158           | 1                  | 12                 |                        |       |
| Shares purchased and retired .....  | (85,900)         | (1)                | (87)               |                        |       |
| Net loss .....                      |                  |                    |                    | (4,801)                |       |
| Balance at September 30, 2002 ..... | 25,355,685       | \$ 254             | \$ 69,902          | \$ (11,176)            | \$    |
|                                     | =====            | =====              | =====              | =====                  | ===== |

See accompanying notes.

6

Mace Security International, Inc.

Consolidated Statements of Cash Flows  
(Unaudited)

(In thousands)

|   | Nine Months<br>September |
|---|--------------------------|
|   | -----                    |
|   | 2002                     |
|   | -----                    |
| Operating activities  |                          |
| Net (loss) income   | \$ (4,801)               |
| Adjustments to reconcile net (loss) income<br>to net cash provided by operating activities: |                          |
| Depreciation and amortization   | 1,456                    |
| Provision for losses on receivables   | 71                       |
| Gain on disposal of property and equipment  | -                        |
| Deferred income taxes   | 419                      |
| Non-cash charge due to change in accounting principle                                       | 5,733                    |
| Changes in operating assets and liabilities:  |                          |
| Accounts receivable   | (139)                    |
| Inventories   | 112                      |
| Accounts payable  | (357)                    |
| Deferred revenue  | (29)                     |
| Accrued expenses  | 535                      |
| Income taxes  | (86)                     |
| Prepaid expenses and other assets   | 144                      |
| Net cash provided by operating activities   | 3,058                    |
| Investing activities  |                          |
| Purchase of property and equipment  | (531)                    |
| Proceeds from sale of property and equipment  | -                        |
| Acquisition of business, net of cash acquired   | (217)                    |

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|  |          |
|--|----------|
| Payments for intangibles                                 | (5)      |
|  | -----    |
| Net cash (used in) provided by investing activities      | (753)    |
|  |          |
| Financing activities                                     |          |
| Payments on long-term debt and capital lease obligations | (1,615)  |
| Payments to purchase stock                               | (88)     |
|  | -----    |
| Net cash used in financing activities                    | (1,703)  |
|  | -----    |
| Net increase in cash and cash equivalents                | 602      |
| Cash and cash equivalents at beginning of period         | 6,612    |
|  | -----    |
| Cash and cash equivalents at end of period               | \$ 7,214 |
|  | =====    |

See accompanying notes.

7

Mace Security International, Inc.

Notes to Consolidated Financial Statements  
(Unaudited)

### 1. Basis of Presentation and Principles of Consolidation

The accompanying unaudited consolidated financial statements include the accounts of Mace Security International, Inc. and its wholly owned subsidiaries (collectively "the Company"). All significant intercompany transactions have been eliminated in consolidation. These consolidated financial statements reflect all adjustments (including normal recurring accruals), which in the opinion of management, are necessary for a fair presentation of results of operations for the interim periods presented. The results of operations for the three and nine month periods ended September 30, 2002 are not necessarily indicative of the operating results for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These interim financial statements should be read in conjunction with the audited financial statements and notes contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

### 2. Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") 141, Business Combinations, and SFAS 142, Goodwill and Other Intangible Assets. SFAS 141 is effective for all business combinations completed after June 30, 2001. SFAS 142 is effective for fiscal years beginning after December 15, 2001; however, certain provisions of this Statement apply to goodwill and other intangible assets acquired between July 1, 2001 and the effective date of SFAS 142. Major provisions of these Statements and their effective dates for the Company are as follows:

- . All business combinations initiated after June 30, 2001 must use the purchase method of accounting. The pooling of interests method of accounting is prohibited except for transactions initiated before July 1, 2001.
- . Intangible assets acquired in a business combination must be recorded



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separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability.

- . Goodwill, as well as intangible assets with indefinite lives, acquired after June 30, 2001, will not be amortized.=
- . Effective January 1, 2002, all previously recognized goodwill and intangible assets with indefinite lives will no longer be subject to amortization.
- . Effective January 1, 2002, goodwill and intangible assets with indefinite lives will be tested for impairment annually and whenever there is an impairment indicator.
- . All acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting.

On January 1, 2002, the Company adopted SFAS 142, and as required, discontinued amortization of goodwill and certain intangible assets determined to have indefinite useful lives acquired prior to July 1, 2001. This statement also requires that within the first interim period of adoption, the intangible assets with indefinite lives should be tested for impairment as of the date of adoption, and that if any impairment results, it should be recognized as a change in accounting principle. Additionally, SFAS 142 requires that, within six months of adoption, goodwill be tested for impairment at the reporting unit level as of the date of adoption. If any impairment is indicated to have existed upon adoption, it should be measured and recorded before the end of the year of adoption. SFAS 142 requires that any goodwill impairment loss recognized as a result of initial application be reported in the first interim period of adoption as a change in accounting principle and that the income per share effects of the accounting change be separately disclosed. The first phase of the goodwill transitional impairment testing was completed during the second quarter of 2002 and as of January 1, 2002. The transitional impairment testing was completed with goodwill impairment recorded during the third quarter of 2002 and as of January 1, 2002. (See Note 3, Change in Accounting Principle.)

In August 2001, the FASB issued SFAS 143, Accounting for Asset Retirement Obligations. SFAS 143 applies to all entities, including rate-regulated entities, that have legal obligations associated with the retirement of a tangible long-lived asset that result from acquisition, construction or development and (or) normal operations of the long-lived asset. SFAS 143 is effective for fiscal years beginning after June 15, 2002. The provisions of the Statement are not expected to have a material impact on the financial condition or results of operations of the Company.

In August 2001, the FASB issued SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS 144 retains the existing requirements to recognize and measure the impairment of long-lived assets to be held and used or to be disposed of by sale. However, SFAS 144 makes changes to the scope and certain measurement requirements of existing accounting guidance. SFAS 144 also changes the requirements relating to reporting the effects of a disposal or discontinuation of a segment of a business. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim

periods within those fiscal years. The adoption of this Statement did not have a significant impact on the financial condition or results of operations of the Company.

In April 2002, the FASB approved the issuance of SFAS 145, "Rescission of FASB

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Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS 145 primarily affects the reporting requirements and classification of gains and losses from the extinguishment of debt and requires that certain lease modifications with economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. SFAS 145 is effective for fiscal years beginning after May 15, 2002. The Company believes this statement will not materially affect the Company's financial position or results of operations.

In June 2002, the FASB approved the issuance of SFAS 146, "Accounting for Exit or Disposal Activities." SFAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the Emerging Issues Task Force (EITF) has set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 will be effective for exit or disposal activities that are initiated after December 31, 2002. The Company believes this Statement will not materially affect the Company's financial position or results of operations.

### 3. Change in Accounting Principle

Effective January 1, 2002, we adopted SFAS 142, "Goodwill and Other Intangible Assets." In connection with the adoption, we discontinued approximately \$886,000 in annual amortization of goodwill. SFAS 142 also requires companies to test intangibles for impairment on an annual basis. During the first quarter of 2002, the Company performed its testing under SFAS 142 pertaining to its evaluation of intangible assets determined to have indefinite useful lives, and determined that there was an impairment issue with certain trademarks used in our security products segment. The fair values of the trademarks were determined using a royalty savings approach, discounted at appropriate risk-adjusted rates, which yielded results consistent with available market-approach data. The impairment of \$43,000, net of tax, was recorded as a cumulative effect of a change in accounting principle at March 31, 2002.

The following table reflects unaudited adjusted results of operations of the Company, giving effect to the amortization of goodwill provisions of SFAS 142 as if they were adopted on January 1, 2001 (in thousands except earnings per share):

|   | Three Months Ended<br>September 30, |         | Ni   |
|---|-------------------------------------|---------|------|
|   | 2002                                | 2001    | 2002 |
| (Loss) income before cumulative effect of change<br>in accounting principle, as reported            | \$ (116)                            | \$ (20) | \$   |
| Add back: amortization expense, net of tax  | -                                   | 140     |      |
| Pro forma (loss) income before cumulative effect<br>of change in accounting principle               | \$ (116)                            | \$ 120  | \$   |
| Basic (loss) income before cumulative effect of<br>change in accounting principle per common share: |                                     |         |      |
| As reported   | \$ -                                | \$ -    | \$   |
| Pro forma   | \$ -                                | \$ -    | \$   |

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Diluted (loss) income before cumulative effect of  
change in accounting principle per common share:

|             |    |   |    |   |    |
|-------------|----|---|----|---|----|
| As reported | \$ | - | \$ | - | \$ |
| Pro forma   | \$ | - | \$ | - | \$ |

Under the provisions of SFAS 142, the Company was required to complete the first phase of the goodwill transitional impairment test within six months of adopting the new standard or by June 30, 2002 and the final phase of the transitional test before the end of the year of adoption, or December 31, 2002. The first step of the transitional testing was the determination of our reporting units and the estimation of the fair values of the reporting units. A discounted cash flow model was used to estimate the fair value of our reporting units. The Company engaged an independent appraisal firm to determine appropriate discount rates for each reporting unit. Discount rates were derived by using the weighted average cost of capital technique. The discount rates were then

9

used by the Company in the discounted cash flow calculations. Significant estimates and assumptions were used in assessing the fair value of the reporting units. These estimates and assumptions involved future cash flows, growth rates, discount rates, weighted average cost of capital and estimates of market valuations of each of the reporting units. During the third quarter of 2002, we completed the transitional requirements for goodwill impairment testing. As a result of the transitional goodwill impairment testing, we determined that the book value of our Northeast reporting unit exceeded its current fair value by \$1.84 million. The Northeast reporting unit's current fair value was based on present expectations for the business in light of the current economic environment and the uncertainty associated with recent volume due to unfavorable weather patterns. Additionally, there was an impairment of \$5.34 million in our Arizona reporting unit due to unfavorable economic conditions combined with a significant increase in local competition. This charge represented a complete write-off of the goodwill associated with this reporting unit. Finally, there was an impairment loss of \$670,000 in our truck wash reporting unit, primarily because we did not acquire additional truck washes necessary to achieve the scale needed to attract national accounts. This charge represented a complete write-off of the goodwill associated with this reporting unit.

The total after-tax impairment charge of \$5.7 million is considered a change in accounting principle, and the cumulative effect of adopting SFAS 142 on our first quarter's results is provided below (in thousands except per share information):

|  |    |         |       | Basic<br>Earnings (Loss)<br>Per Share |       |
|--|----|---------|-------|---------------------------------------|-------|
|  |    |         | ----- | -----                                 |       |
| Net income as reported for the three months<br>ended March 31, 2002      | \$ | 647     | \$    | 0.03                                  | \$    |
| Less: cumulative effect of change in accounting<br>principle, net of tax | \$ | (5,689) | \$    | (0.23)                                | \$    |
| Adjusted to include impairment charge                                    | \$ | (5,042) | \$    | (0.20)                                | \$    |
|  |    |         | ===== | =====                                 | ===== |

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The changes in the carrying amount of goodwill for the nine months ended September 30, 2002 are as follows (in thousands):

|  | East     | Texas    | Arizona  | Truck Washes | Security Products |
|--|----------|----------|----------|--------------|-------------------|
| Balance at December 31, 2001                           | \$ 6,508 | \$ 7,620 | \$ 5,341 | \$ 670       | \$                |
| Reallocation of purchase price                         | 862      | -        | -        | -            |                   |
| Acquisition of Micro-Tech Manufacturing, Inc.          | -        | -        | -        | -            | 2                 |
| Transitional impairment loss upon adoption of SFAS 142 | (1,842)  | -        | (5,341)  | (670)        |                   |
| Balance at September 30, 2002                          | \$ 5,528 | \$ 7,620 | \$ -     | \$ -         | \$ 2              |

Additionally, impairment of goodwill and intangible assets with indefinite lives must be tested on at least an annual basis. The Company cannot guarantee that there will not be impairments in a subsequent quarter in 2002 or in subsequent years.

10

#### 4. Other Intangible Assets

The following table reflects the components of intangible assets, excluding goodwill (in thousands):

|  | September 30, 2002    |               |                       |
|--|-----------------------|---------------|-----------------------|
|  | Gross Carrying Amount | Accum. Amort. | Gross Carrying Amount |
| Amortized intangible assets:           |                       |               |                       |
| Non-compete agreement                  | \$ 25                 | \$ -          | \$                    |
| Customer list                          | 25                    | -             |                       |
| Deferred financing costs               | 365                   | 123           |                       |
| Total amortized intangible assets      | 415                   | 123           |                       |
| Non-amortized intangible assets:       |                       |               |                       |
| Trademarks - security products segment | 1,835                 | 1,270         |                       |
| Service mark - car care segment        | 116                   | 10            |                       |
| Total non-amortized intangible assets  | 1,951                 | 1,280         |                       |
| Total intangible assets                | \$ 2,366              | \$ 1,403      | \$                    |

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The following sets forth the estimated amortization expense on intangible assets for the fiscal years ending December 31 (in thousands):

|      |       |
|------|-------|
| 2002 | \$ 28 |
| 2003 | 29    |
| 2004 | 28    |
| 2005 | 28    |
| 2006 | 28    |

### 5. Business Combinations

From April 1, 1999 through July 26, 2000, the Company acquired 62 car care facilities and five truck wash facilities through the acquisition of 17 separate businesses including: 42 full service facilities, one self service facility, 11 exterior only facilities and one lube center in Pennsylvania, New Jersey, Delaware, Texas, Florida and Arizona; seven facilities were subsequently divested. The five full service truck wash facilities are located in Arizona, Indiana, Ohio and Texas.

On August 28, 2001, the Company sold, through a wholly owned subsidiary, substantially all of the assets of Gabe's Plaza Car Wash in Morrisville, Pennsylvania. The Company received an aggregate cash sales price of \$1.2 million, \$315,000 of which was utilized to pay off a promissory note secured by the Gabe's Plaza Car Wash assets.

On August 12, 2002, the Company acquired the inventory, certain other assets and the operations of Micro-Tech Manufacturing, Inc. ("Micro-Tech"), a manufacturer and retailer of small and miniature electronic security devices. Total consideration under the agreement was approximately \$505,000. At closing, the Company paid \$217,000 cash for inventory, \$15,625 cash representing the first of twelve equal monthly installments totaling \$187,500, and 13,158 registered shares of common stock of the Company representing the first of eight monthly payments of shares totaling 105,263 shares. This transaction was accounted for using the purchase method of accounting in accordance with SFAS 141, "Business Combinations."

### 6. Operating Agreement

The Company has been directly operating its Security Products Division since May 1, 2002. The results of operations of the Security Products Division since then are included in the consolidated statements of operations for the three and nine months ended September 30, 2002. Previous to May 1, 2002, the Security Products division was operated by Mark Sport, Inc. ("Mark Sport") under a management agreement which expired on April 30, 2002 (the "Management Agreement"). Mark Sport is controlled by Jon E. Goodrich, a Director of the Company. Under the Management Agreement, beginning on January 1, 2000, Mark Sport operated the division and received all profits and losses therefrom. In exchange, Mark Sport paid the Company a monthly fee and, upon termination of the agreement, an amount equal to the amortization and depreciation of the assets of the division. (See Note 11, Related Party Transactions.)

11

### 7. Commitments and Contingencies

In December 1999, the Company was named as a defendant in a suit filed in the state of New York by Janeen Johnson et. al. The litigation concerns a claim that a self-defense spray manufactured by the Company and used by a law enforcement

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officer contributed to the suffering and death of Christopher Johnson. The Company forwarded the suit to its insurance carrier for defense. The Company does not anticipate that this claim will result in the payment of damages in excess of the Company's insurance coverage.

In 2000, the Company was named as a defendant in a suit filed in the United States District Court for the District of Colorado by Robert Rifkin. The suit alleges that the Company and its transfer agent delayed in the removal of a restrictive legend from certain shares of Company common stock owned by the plaintiff, and that the delay caused the plaintiff to incur a loss in excess of \$335,000. Though the outcome of litigation is always uncertain, the Company believes that there was no delay in the removal of the legend from the shares.

In July 2001, the Company filed a lawsuit in the Supreme Court of New York County of the state of New York against LTV Networks, Inc., to collect upon a promissory note in the amount of \$100,000. In January 2002, defendant LTV filed an answer to the suit denying liability under the promissory note and making counterclaims. The counterclaims allege that the Company had agreed to lend LTV \$500,000 and that LTV has been damaged in the amount of \$10 million because the Company only lent \$100,000 to LTV. The parties are presently completing discovery and depositions. Though the outcome of litigation is always uncertain, the Company currently believes that the counterclaims are without merit.

In October 2001, the Company was named as an additional party defendant in a suit filed by Alan Berndt and Martha Berndt in the United States District Court for the Northern District of California. The litigation alleges the Company was responsible for personal injuries arising out of Mr. Berndt's use of a Gas Launcher. We have forwarded the suit to our insurance carrier for defense. We do not anticipate that this claim will result in the payment of damages in excess of our insurance coverage.

In May 2002, the Company was named as one of three defendants in a suit filed by Timothy Gamradt and Carla Gamradt in the United States District Court for the District of Minnesota. The litigation alleges that the plaintiffs are entitled to damages against the Company due to injuries allegedly sustained by Mr. Gamradt when a pyrotechnic smoke device known as the "Black Smoke Device" was discharged by Mr. Gamradt's superior during a training exercise at a federal prison facility at which Mr. Gamradt was employed as a guard. Mr. Gamradt alleges that when the device was activated, he suffered injuries to his lungs. We have forwarded the suit to our insurance carrier for defense. We do not anticipate that this claim will result in the payment of damages in excess of our insurance coverage.

In July 2002, the Company and its former president, Jon Goodrich, were named as defendants in a lawsuit in the Supreme Court of New York County of the state of New York filed by Armor Holdings, et al. The suit alleges that the Company and Mr. Goodrich had violated the non-compete terms of various agreements entered into in April 1998, which transferred certain of the Company's then lines of business to the plaintiffs. The suit also alleges that the Company violated a right of first refusal on sale granted to plaintiffs, when the Company entered into a Management Agreement with Mark Sport, Inc., to operate the Company's Security Products Division. Though the outcome of litigation is always uncertain, the Company believes that all of the claims are without merit, and will be defending the suit.

The Company is a party to various other legal proceedings related to its normal business activities. In the opinion of the Company's management, none of these proceedings are material in relation to the Company's results of operations, liquidity, cash flows or financial condition.

Although the Company is not aware of any substantiated claim of permanent personal injury from its products, the Company is aware of reports of incidents

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in which, among other things, defense sprays have been mischievously or improperly used, in some cases by minors; have not been instantly effective; or have been ineffective against enraged or intoxicated individuals. Incidents of this type, or others, could give rise to product liability or other claims, or to claims that past or future advertising, packaging or other practices should be, or should have been, modified, or that regulation of products of this nature should be extended or changed.

The Company is subject to federal and state environmental regulations, including rules relating to air and water pollution and the storage and disposal of oil, other chemicals and waste. The Company believes that it complies with all applicable laws relating to its business.

Certain of the Company's executive officers have entered into employment agreements whereby they will be entitled to immediate

12

vesting provisions of issued options should the officer be terminated upon a change in control of the Company. Additionally, the employment agreement of the Company's Chief Executive Officer, Louis D. Paolino, Jr., entitles Mr. Paolino to receive a fee of \$7,000,000 upon termination of employment under certain conditions including upon termination as a result of a change in control.

### 8. Business Segments Information

The Company currently operates in two segments: the Car Care segment, supplying complete car care services (including wash, detailing, lube, and minor repairs), fuel, and merchandise sales; and the Security Products segment. From January 1, 2000 through April 30, 2002, the Company was paid \$20,000 per month under a Management Agreement pursuant to which Mark Sport, an entity controlled by Jon E. Goodrich, a director of the Company, operated the Company's Security Products Division. Effective May 1, 2002, the Management Agreement expired and the Company recommenced operation of the Security Products Division.

Financial information regarding the Car Care and Security Products segments is as follows:

|                                       | Car<br>Care | Security<br>Products |
|---------------------------------------|-------------|----------------------|
|                                       |             | (In Thousands)       |
| Three months ended September 30, 2002 |             |                      |
| Revenues from external customers      | \$ 10,671   | \$ 1,1               |
| Intersegment revenues                 | -           |                      |
| Segment income (loss)                 | \$ 359      | \$                   |
| Segment assets                        | \$ 90,982   | \$ 4,5               |
| Nine months ended September 30, 2002  |             |                      |
| Revenues from external customers      | \$ 33,804   | \$ 1,6               |
| Intersegment revenues                 | -           |                      |
| Segment (loss) income                 | \$ (3,416)  | \$                   |
| Three months ended September 30, 2001 |             |                      |
| Revenues from external customers      | \$ 10,905   | \$                   |
| Intersegment revenues                 | -           |                      |
| Segment income (loss)                 | \$ 240      | \$                   |
| Nine months ended September 30, 2001  |             |                      |
| Revenues from external customers      | \$ 36,656   | \$ 1                 |

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|                       |    |       |    |
|-----------------------|----|-------|----|
| Intersegment revenues |    | -     |    |
| Segment income (loss) | \$ | 1,781 | \$ |

- \* Corporate functions include the corporate treasury, legal, financial reporting, information technology, corporate tax, corporate insurance, human resources, investor relations, and other typical centralized administrative functions.

### 9. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. Such estimates include the Company's estimates of reserves such as the allowance for doubtful accounts, inventory valuation allowances, insurance losses and loss reserves, valuation of long-lived assets, estimates of realization of income tax net operating loss carryforwards, as well as valuation calculations such as the Company's goodwill impairment calculations under the provisions of SFAS 142.

### 10. Income Taxes

The Company recorded a tax benefit of \$65,000 for the three months ended September 30, 2002 and a tax expense of \$524,000 for the nine months ended September 30, 2002. Tax expense reflects the recording of income taxes on income before cumulative effect of a change in accounting principle at an effective rate of 36%. The effective rate differs from the federal statutory rate primarily due to state and local income taxes, non-deductible costs related to acquired intangibles, and the use of net operating loss carryforwards.

### 11. Related Party Transactions

In August 1999, Mace entered into a month-to-month lease arrangement with Bluepointe, Inc., a corporation controlled by Louis D. Paolino, Jr., Mace's Chairman, Chief Executive Officer and President, for Mace's executive offices in Mt. Laurel, New Jersey.

13

The leased offices are in a 41,000 square foot class "B" office building. The lease arrangement provided for monthly rental payments of \$10,000. This monthly lease payment was considered to be more favorable than could be obtained on the open market for similar facilities. Effective August 1, 2000, after a survey of local real estate market pricing and upon the approval of the Audit Committee, Mace entered into a five year lease with Bluepointe, Inc. which provides for an initial monthly rental payment of \$15,962, which increases by 5% per year in the third through fifth years of the lease. Mace believes that the terms of this lease (based on an annual rate of \$19.00 per square foot ) are competitive when compared to similar facilities in the Mt. Laurel, New Jersey area. Mace has also entered into a three-year furniture lease/purchase agreement with Bluepointe, Inc., dated January 1, 2001, which provided for an initial payment of \$20,000 and monthly rental payments thereafter of \$4,513, for the use of the furnishings in Mace's executive offices. The rental rates were based upon a third-party valuation of the furnishings, and Mace believes that the terms of the furniture lease are competitive with similar leasing arrangements available in the local area.

The Company purchased charter airline services from Air Eastern, Inc., and LP Learjets, LLC, charter airline companies owned by Louis D. Paolino, Jr., the



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Company's Chairman, Chief Executive Officer and President. The Company paid \$60,000 in fiscal 2001 and \$25,544 through July 2002. No payments for charter services have been made by the Company after July 2002.

In 2001, \$15,000 was paid to Aeroways, Inc., a chartered air service company not affiliated with Louis D. Paolino, Jr., for the direct costs of flying the Learjet 31A owned by LP Learjets, LLC. The Company believes that the rates charged are competitive when compared with similar services provided by independent airline charter companies.

On November 6, 2001, the Audit Committee approved an arrangement subject to quarterly review under which the Company prepays LP Learjets, LLC \$5,109 per month for the right to use a Learjet 31A for 100 hours per year. Additionally, when the Learjet 31A is used, the Company pays to third parties unaffiliated with Louis D. Paolino, Jr., the direct costs of the Learjet's per-hour use, which include fuel, pilot fees, engine insurance and landing fees. As of July 2002, the Company is no longer prepaying LP Learjets, LLC for the future right to use the Learjet 31A.

In February 2000, the Company entered into a Management Agreement with Mark Sport, Inc. ("Mark Sport"), a Vermont corporation controlled by Jon E. Goodrich, a director of the Company. The Management Agreement entitled Mark Sport to operate the Company's Security Products Division and receive all profits or losses for a seven-month term beginning January 1, 2000. The Management Agreement was extended several times through amendments. The Management Agreement required Mark Sport to pay the Company \$20,000 per month beginning February 2000 and continuing through April 30, 2002, the extended term of the Management Agreement. Additionally, Mark Sport paid the Company an amount equal to the amortization and depreciation on the assets of the division. During the term of the Management Agreement, Mark Sport operated the division in substantially the same manner as it was operated prior to the Management Agreement. On February 21, 2002, Mark Sport and the Company amended the Management Agreement. The amendment extended the term of the Management Agreement through April 30, 2002, and reconciled the amount owed by Mark Sport to the Company under the Management Agreement from February 2000 through December 31, 2001. Mark Sport and the Company agreed in the amendment that Mark Sport, as of December 31, 2001, owed the Company \$127,000, resulting in a resolution of certain disputes and a reduction of the amounts owed by Mark Sport of approximately \$92,000. The Management Agreement expired on April 30, 2002 and was further amended on July 22, 2002 to reconcile the amount owed by Mark Sport to Mace under the Management Agreement for the period January 1, 2002 through April 30, 2002. Mark Sport and Mace agreed in their final amendment that Mark Sport owed the Company \$100,000 for this period, resulting in a resolution of certain disputes and a reduction of the amounts recorded by the Company as owed by Mark Sport of approximately \$39,000. At September 30, 2002, Mark Sport owed the Company \$127,000.

The Company's Security Products Division leases manufacturing and office space under a five-year lease with Vermont Mill, Inc. ("Vermont Mill"), which provides for monthly lease payments of \$6,667 beginning November 15, 1999. Vermont Mill is controlled by Jon E. Goodrich, a director of the Company. On February 25, 2002, the Company and Vermont Mill amended the lease. The original lease provided that Vermont Mill could increase the lease payment \$0.50 per square foot upon demonstration that Vermont Mill had a higher paying third party tenant for the space occupied by the Company. The lease amendment clarifies that the Company occupies 44,000 square feet in the Vermont Mill building at a rental rate of \$2.50 per square foot per year. The Company believes that the revised lease rate is lower than lease rates charged for similar properties in the Bennington, Vermont area. On July 22, 2002, the lease was further amended to provide Mace the option and right to cancel the lease with proper notice and a payment equal to six months of the then current rent for the leased space occupied by Mace.

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Vermont Mill borrowed a total of \$228,671 from the Company through December 31, 2001. On February 22, 2002, Vermont Mill executed a three year promissory note with monthly installments of \$7,061 including interest at a rate of 7%. The Company's Lease Agreement with Vermont Mill provides for a right of offset of lease payments against this promissory note in the event monthly payments are not made by Vermont Mill. At September 30, 2002, the balance owed on this promissory note was \$194,935.

14

### 12. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

|   | Three Months Ended |            | Nine Months |
|---|--------------------|------------|-------------|
|   | 9/30/02            | 9/30/01    | 9/30/02     |
| Numerator:  |                    |            |             |
| Net (loss) income (in thousands) .....  | \$ (116)           | \$ (20)    | \$ (4,801)  |
|   | =====              | =====      | =====       |
| Denominator:  |                    |            |             |
| Denominator for basic (loss) income<br>per share - weighted<br>average shares .....   | 25,353,136         | 25,428,427 | 25,362,849  |
| Dilutive effect of options and<br>warrants .....                                      | -                  | -          | 54,102      |
|   | -----              | -----      | -----       |
| Denominator for diluted (loss)<br>income per share - weighted<br>average shares ..... | 25,353,136         | 25,428,427 | 25,416,951  |
|   | =====              | =====      | =====       |
| Basic (loss) income per share .....   | \$ -               | \$ -       | \$ (0.19)   |
|   | =====              | =====      | =====       |
| Diluted (loss) income per share .....   | \$ -               | \$ -       | \$ (0.19)   |
|   | =====              | =====      | =====       |

### 13. Subsequent Events

In October 2002, the Company purchased a block of 429,000 common shares of the Company's stock in the open market at a price of \$.51 per share. The Company retired these shares.

On October 2, 2002, the Company was advised by Nasdaq that its common stock has failed to maintain a minimum bid price of \$1.00 over the last 30 consecutive trading days as required by the Nasdaq National Market under Marketplace Rules (see Management's Discussion and Analysis - Risk Factors).

On November 6, 2002, the Company filed a preliminary proxy statement in preparation for the holding of a special meeting of the Company's stockholders

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on December 16, 2002. The purpose of the special meeting is to approve an amendment to the Company's charter which will effect a one-for-two reverse stock split of the Company's issued and outstanding common stock. The Board of Directors is authorized not to file the Amended and Restated Certificate of Incorporation and not implement the reverse stock split, if after the special meeting the Board of Directors determines that it would not be in the best interest of Mace to effect the reverse stock split.

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of the financial condition and results of operations should be read in conjunction with the financial statements and the notes thereto included in this Form 10-Q.

#### Forward Looking Statements

This report includes forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended ("Forward Looking Statements"). All statements other than statements of historical fact included in this section are Forward Looking Statements. Although we believe that the expectations reflected in such Forward Looking Statements are reasonable, we can give no assurance that such expectations will prove to have been correct. Generally, these statements relate to business plans or strategies, projected or anticipated benefits or other consequences of such plans or strategies, number of acquisitions and projected or anticipated benefits from acquisitions made by or to be made by us, or projections involving anticipated revenues, earnings, levels of capital expenditures or other aspects of operating results. All phases of our operations are subject to a number of uncertainties, risks and other influences, many of which are outside our control and any one of which, or a combination of which, could materially affect the results of our operations and whether Forward Looking Statements made by us ultimately prove to be accurate. Such Risk Factors that could cause actual results to differ materially from our expectations are disclosed in this section and elsewhere in this report. All subsequent written and oral Forward Looking Statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the Risk Factors described below that could cause actual results to differ from our expectations. The Forward Looking Statements made herein are only made as of the date of this filing, and we undertake no obligation to publicly update such Forward Looking Statements to reflect subsequent events or circumstances.

15

#### Summary of Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the Company's financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. The Company believes that its critical accounting policies include those described below.

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### Revenue Recognition

Revenue from the Company's Car Care segment is recognized, net of customer coupon discounts, when services are rendered or fuel or merchandise is sold.

Revenue from the Company's Security Products sales segment is recognized when shipments are made, or for export sales when title has passed.

### Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in first-out (FIFO) method for security and car care products. Inventories at the Company's Car Care locations consist of various chemicals and cleaning supplies used in operations and merchandise and fuel for resale to consumers. Inventories within the Company's Security Products segment consist of defense sprays, child safety products, electronic security monitors, cameras and digital recorders, and various other consumer security and safety products.

### Property and Equipment

Property and equipment are stated at cost. Depreciation is recorded using the straight-line method over the estimated useful lives of the assets, which are generally as follows: buildings and leasehold improvements - 15 to 40 years; machinery and equipment - 2 to 20 years; and furniture and fixtures - 5 to 10 years. Significant additions or improvements extending assets' useful lives are capitalized; normal maintenance and repair costs are expensed as incurred.

### Goodwill

In 2001, goodwill was amortized on a straight line basis over 25 years.

On January 1, 2002, the Company adopted SFAS 142, and as required, discontinued amortization of goodwill acquired prior to July 1, 2001. Additionally, SFAS 142 requires that, within six months of adoption, the first phase of the goodwill transitional impairment testing be completed at the reporting unit level as of the date of adoption. If any impairment is indicated to have existed upon adoption, it should be measured and recorded before the end of the year of adoption. SFAS 142 requires that any goodwill impairment loss recognized as a result of initial application be reported in the first interim period of adoption as a change in accounting principle and that the income per share effects of the accounting change be separately disclosed. The transitional impairment testing was completed during the third quarter of 2002 and as of December 31, 2001 (See Note 3, Change in Accounting Principle).

In accordance with SFAS 142, the Company will be subject to a 2002 annual impairment test as well as impairment tests each year thereafter. Significant estimates and assumptions are used in assessing the fair value of the reporting units and determining impairment to goodwill. The Company cannot guarantee that there will not be impairments in a subsequent quarter in 2002 or in subsequent years.

### Other Intangible Assets

Other intangible assets consist primarily of deferred financing costs, trademarks and a registered national brand name. Prior to 2002, our trademarks and brand name were amortized on a straight line basis over 15 years. In accordance with SFAS 142, our trademarks and brand name are considered to have indefinite lives, and as such, are no longer subject to amortization. These

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assets will be tested for impairment annually and whenever there is an impairment indicator. Deferred financing costs are amortized on a straight line basis over the terms of the respective debt instruments. Customer lists and non-compete agreements are amortized on a straight-line basis over their respective estimated useful lives.

### Deferred Acquisition Costs

The Company capitalizes legal, accounting, engineering and other direct costs paid to outside parties that are incurred in connection with potential acquisitions. The Company, however, routinely evaluates such capitalized costs and charges to expense those relating to abandoned acquisition candidates. Indirect acquisition costs, such as executive salaries, general corporate overhead, and other corporate services are expensed as incurred.

### Income Taxes

Deferred income taxes are determined based on the difference between the financial accounting and tax bases of assets and liabilities. Deferred income tax expense represents the change during the period in the deferred income tax assets and deferred income tax liabilities. Deferred tax assets include tax loss and credit carryforwards and are reduced by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

### Deferred Revenue

The Company records a liability for gift certificates, ticket books, and periodic wash passes sold at its car care locations but not yet redeemed. The Company estimates these unredeemed amounts based on gift certificate, ticket book and periodic pass sales and redemptions throughout the year as well as utilizing historical sales and redemption rates.

### Advertising

The Company expenses advertising costs, including advertising production costs, as they are incurred or the first time advertising takes place. The Company's costs of coupon advertising are recorded as a prepaid asset and amortized to advertising expense during the period of distribution and customer response, typically two to three months.

## Introduction

### Revenues

#### Car Care Services

We own full service, exterior only and self-service car wash locations in New Jersey, Pennsylvania, Delaware, Texas, Florida and Arizona, as well as truck washes in Arizona, Indiana, Ohio and Texas. We earn revenues from washing and detailing automobiles; performing oil and lubrication services, minor auto repairs, and state inspections; selling fuel; and selling merchandise through convenience stores within the car wash facilities. Revenues generated for the nine months ended September 30, 2002 for the car care segment were comprised of approximately 84% car wash and detailing, 9% lube and other automotive services, 7% fuel and merchandise.

The majority of revenues are collected in the form of cash or credit card receipts, thus minimizing customer accounts receivable.

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Weather can have a significant impact on volume at the individual locations. We believe that the geographic diversity of our operating locations spreads the risk of adverse weather-related influence on our volume.

### Security Products

During 2001 and for the first four months of 2002, the Company was paid \$20,000 per month under a Management Agreement pursuant to which Mark Sport, Inc., an entity controlled by Jon E. Goodrich, a director of the Company, operated the Security Products segment. Effective May 1, 2002, the Management Agreement expired and the Company recommenced operation of the Security Products segment. The Company operated its security products segment in two main business units, the Consumer Products Division and the Mace Anti-Crime Bureau. The Company's Consumer Products operations manufacture and market personal safety, and home and auto security products which are sold through retail stores, major discount stores, domestic and international distributors, and at the Company's car care facilities. The Mace Anti-Crime Bureau operations provide expertise in developing and producing criminal deterrent systems for financial institutions.

17

With the acquisition of certain of the assets of Micro-Tech, a manufacturer and retailer of electronic security and surveillance devices on August 12, 2002, the Company added an additional business unit to its Security Products segment. The Company plans to add the security cameras, closed-circuit monitors, digital recording devices and related electronic security components to its line of well-known personal security products. The Company is purchasing these items for resale from OEM manufacturers. As with all new business undertakings, there are numerous risks associated with the new business unit that may prevent the Company from operating it profitably, including, among others: risks associated with unanticipated problems in the acquired company; risks inherent with management not having experience in electronic security device design, purchasing and marketing; risks associated with our efforts to integrate the line of products with our existing product lines to capitalize on name recognition and marketing efficiencies; risks relating to the size and number of competitors in the electronic security device market, many of whom may be more experienced or better financed; risks associated with the costs of planned entry into new markets and expansion of product lines in old markets; and risks attendant to locating and maintaining reliable sources of OEM products and component supplies in the electronic industry.

### Cost of Revenues

#### Car Care Services

Cost of revenues consists primarily of direct labor and related taxes and benefits, chemicals, wash and detailing supplies, rent, real estate taxes, utilities, car damages, maintenance and repairs of equipment and facilities, as well as the cost of the fuel and merchandise sold.

#### Security Products

During 2001 and for the first four months of 2002, the Security Products segment was operated under a Management Agreement by Mark Sport. Accordingly, during that time, no costs were incurred by the Company. Beginning in May of 2002, cost of revenues consists primarily of costs to manufacture the security products including direct labor and related taxes and benefits, and raw material costs. It is anticipated that the new electronic security device business unit acquired during the current quarter will incur costs related to product returns and warranties and customer support, but those were insignificant during the current

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quarter.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of management, clerical and administrative salaries, professional services, insurance premiums, sales commissions, and other costs relating to marketing and sales.

We capitalize direct incremental costs associated with purchase acquisitions. Indirect acquisition costs, such as executive salaries, corporate overhead, public relations, and other corporate services and overhead are expensed as incurred. The Company also charges as an expense any capitalized expenditures relating to proposed acquisitions that will not be consummated.

At September 30, 2002, there were no capitalized costs related directly to proposed acquisitions that were not yet consummated. We periodically review the future likelihood of acquisitions and record appropriate provisions against capitalized costs associated with projects that are not likely to be completed.

### Depreciation and Amortization

Depreciation and amortization consists primarily of depreciation of buildings and equipment, and amortization of certain intangible assets. Buildings and equipment are depreciated over the estimated useful lives of the assets using the straight-line method. Intangible assets, other than goodwill or intangible assets with indefinite useful lives, are amortized over their useful lives ranging from three to fifteen years, using the straight line method. In 2001 goodwill was amortized on a straight-line basis over 25 years. With the adoption of SFAS 142 on January 1, 2002, we no longer amortize goodwill and certain intangible assets, namely trademarks and service marks, determined to have indefinite useful lives.

### Other Income

Other income consists primarily of rental income received on renting out excess space at our car wash facilities and includes gains and losses on the sale of equipment.

18

### Income Taxes

Income tax expense is derived from tax provisions for interim periods that are based on the Company's estimated annual effective rate. Currently, the effective rate differs from the federal statutory rate primarily due to state and local income taxes, non-deductible costs related to acquired intangibles, and the use of net operating loss carryforwards.

The following table presents the percentage each item in the consolidated statements of operations bears to total revenues:

|          | Nine Months En<br>September 30 |
|----------|--------------------------------|
|          | -----<br>2002<br>-----         |
| Revenues | 100.0%                         |

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|  |         |
|--|---------|
| Cost of revenues   | 70.2    |
| Selling, general and administrative expenses                                       | 17.4    |
| Depreciation and amortization  | 4.1     |
| Costs of terminated acquisitions   | 0.1     |
| Operating income   | 8.2     |
| Interest expense, net  | (4.7)   |
| Other income   | 0.6     |
| Income before income taxes and cumulative effect of change in accounting principle | 4.1     |
| Income tax expense   | 1.5     |
| Income before cumulative effect of a change in accounting principle                | 2.6     |
| Cumulative effect of a change in accounting principle, net of tax                  | (16.1)  |
| Net (loss) income  | (13.5)% |

### Liquidity and Capital Resources

#### Liquidity

Cash and cash equivalents was \$7.2 million at September 30, 2002. The ratio of our total debt to total capital, which consists of total debt plus stockholders' equity, was 36% at September 30, 2002 and 35% at December 31, 2001.

Our business requires a substantial amount of capital, most notably to pursue our expansion strategies, including our current expansion in the electronic security products business, and for equipment purchases and upgrades for our car care segment. We plan to meet these capital needs from various financing sources, including borrowings, internally generated funds, and the issuance of common stock if the market price of the Company's stock improves.

As of September 30, 2002, we had working capital of approximately \$183,000. At December 31, 2001, working capital was \$4.8 million and cash and cash equivalents were \$6.6 million. The decrease in working capital at September 30, 2002 is primarily attributable to the reclassification of approximately \$5.4 million of 15 year amortizing loans from long term to current liabilities as a result of these loans being due in either February 2003 or July 2003. The Company intends to renew these loans with the current lender.

We estimate aggregate capital expenditures for our car care segment, exclusive of acquisitions of businesses, of approximately \$150,000 for the remainder of the year ending December 31, 2002. In October 2002, we purchased a building as a warehouse, production and administrative facility for our new electronic security operations. We financed a portion of the \$505,000 purchase price of this building with a long term mortgage of approximately \$400,000. In addition to the purchase of the electronic security products business and facility, we will also expend significant cash for the purchasing of inventory as we introduce new electronic security products and for improvements to the new building. We estimate we will spend approximately \$1 million for electronic security product inventory and approximately \$100,000 for capital improvements



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to the recently purchased building for the remainder of the year ending December 31, 2002.

19

### Debt Capitalization and Other Financing Arrangements

At September 30, 2002, we had borrowings of approximately \$33.5 million. We had two letters of credit outstanding at September 30, 2002, totaling \$304,000 as collateral relating to worker compensation insurance policies. Additionally, we had two commercial letters of credit outstanding at September 30, 2002 totaling \$116,000 for the purchase of inventory for our new electronic security products business. Subsequent to September 30, 2002, several additional commercial letters of credit totaling \$293,000 were issued for inventory purchases. We currently do not have a revolving credit facility, however, we are currently pursuing a revolving credit facility to provide financing for additional security product inventory purchases.

During 2000 and 2001, we refinanced on a long term basis under favorable terms the majority of our short term debt related to our 1999 and 2000 acquisitions. We also had various other long term mortgage notes up for periodic review during 2001 which we have been successful in renewing. Several of our debt agreements, as amended, contain certain affirmative and negative covenants and require the maintenance of certain levels of tangible net worth and the maintenance of certain debt coverage ratios on an individual subsidiary and consolidated level. We were in compliance with all such financial covenants at September 30, 2002. The Company's ability to continue to comply with its debt covenants under its credit arrangement will depend largely on the achievement of adequate levels of cash flow, which could be adversely affected by weather patterns, the economic climate, competitive uncertainties, and other factors. In the event that non-compliance with such debt covenants should occur, the Company would pursue various alternatives to successfully resolve the non-compliance, which might include, among other things, seeking debt covenant waivers or amendments, or refinancing of debt. Although the Company believes that it would be successful in resolving any such potential non-compliance with its debt covenants, there can be no assurance that such would be the case.

The Company is obligated under various operating leases, primarily for certain equipment and real estate within the car care segment. Certain of these leases contain purchase options, renewal provisions, and contingent rentals for proportionate share of taxes, utilities, insurance, and annual cost of living increases. Future minimum lease payments under operating leases with initial or remaining noncancellable lease terms in excess of one year as of September 30, 2002 are as follows: 2003 - \$1.5 million; 2004 - \$1.5 million; 2005 - \$1.2 million; 2006 - \$831,000; 2007 - \$689,000; and thereafter - \$2.5 million.

On April 5, 2000, we executed a master facility agreement with Fusion Capital Fund II, LLC ("Fusion") pursuant to which Fusion agreed to enter into up to two equity purchase agreements, each with an aggregate principal amount of \$12.0 million. The equity purchase agreements allow us to suspend the purchasing of our common stock by Fusion if the price of our common stock is less than \$7.00 per share. We are currently not permitting the purchase of our common stock under the equity purchase agreement due to the current low trading value of our common stock and the potentially dilutive effect of such stock purchases. If and when we agree to the purchase of our stock, Fusion has the right to purchase from us shares of common stock up to \$12.0 million at a price equal to the lesser of (1) 140% of the average of the closing bid prices for our common stock during the 10 trading days prior to the date of the applicable equity purchase agreement or \$7.00, whichever is greater or (2) a price based upon the future performance of the common stock, in each case without any fixed discount to the

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market price. As long as we have not suspended Fusion from purchasing our stock, the equity purchase agreement requires that at the beginning of each month, Fusion will pay us \$1.0 million as partial prepayment for the common stock. Once the \$1.0 million has been applied to purchase shares of our common stock, Fusion will pay the remaining principal amount upon receipt of our common stock. The first equity purchase agreement was executed by Fusion on April 17, 2000. Proceeds from purchased shares through December 31, 2001 totaled approximately \$1.3 million. The first equity purchase agreement was extended to February 20, 2003. The second equity purchase agreement will be executed after delivery of an irrevocable written notice by us to Fusion stating that we elect to enter into such purchase agreement with Fusion. The second equity purchase agreement may be entered into only after the principal amount under the first equity purchase agreement is fully converted into our common stock.

### Cash Flows

**Operating Activities.** Net cash provided by operating activities totaled \$3.1 million for the nine months ended September 30, 2002. Cash provided by operating activities in the first nine months of 2002 was impacted in our Northeast operating region by a mild winter and a spring with low pollen, and unusually high precipitation, especially in our Texas operating region.

**Investing Activities.** Cash used in investing activities totaled \$753,000 for the nine months ended September 30, 2002. The use of cash in the first nine months of 2002 reflects \$531,000 for capital expenditures relating to ongoing car care operations and \$217,000 expended for the acquisition of our new Micro-Tech electronic security device business in August 2002.

20

**Financing Activities.** Cash used in financing activities was \$1.7 million for the nine months ended September 30, 2002. This reflects routine principle payments on debt of \$1.6 million and \$88,000 for the purchase and retirement of shares of our common stock.

### Seasonality and Inflation

The Company believes that its car washing and detailing operations are adversely affected by periods of inclement weather. In particular, long periods of rain and cloudy weather can adversely affect our car wash volumes and related lube and other automotive services as people typically do not wash their cars during such periods. Additionally, extended periods of warm, dry weather may encourage customers to wash their cars themselves which also can adversely affect our car wash business. The Company has mitigated the risk of unfavorable weather patterns by having operations in diverse regions.

The Company believes that inflation and changing prices have not had, and are not expected to have any material adverse effect on its results of operations in the near future.

### Results of Operations for the Nine Months Ended September 30, 2002 Compared to the Nine Months Ended September 30, 2001

#### Revenues

##### Car Care Services

Revenues for the nine months ended September 30, 2002 were \$33.8 million as compared to \$36.6 million for the nine months ended September 30, 2001, a decrease of \$2.8 million or 7.8%. Of the \$2.8 million decrease, approximately

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\$2.1 million was from wash and detail services, \$277,000 was from lube and other automotive services, and \$495,000 was from fuel and merchandise sales. Of the \$33.8 million of revenues for the nine months ended September 30, 2002, \$28.2 million or 84% was generated from car wash and detailing, \$3.2 million or 9% from lube and other automotive services, and \$2.4 million or 7% from fuel and merchandise sales. Of the \$36.6 million of revenues for the nine months ended September 30, 2001, \$30.3 million or 83% was generated from car wash and detailing, \$3.4 million or 9% from lube and other automotive services, and \$2.9 million or 8% from fuel and merchandise sales. The decrease in wash and detailing revenues was principally due to the divesting of two of our car wash locations during 2001 combined with a departure from our historic revenue levels within our Northeast region due to the unusual lack of snow and pollen in the first six months of 2002. The Company also experienced more challenging weather within its Texas region principally within the Dallas/Ft. Worth market for the quarters ended June 30, and September 30, 2002. In addition to these declines in volume, the Company experienced a slight reduction in average wash and detailing revenues per car to \$13.83 in 2002, from \$13.90 per car in the first nine months of 2001. Despite management's continued aggressive focus on selling detailing and additional on-line car wash services, more aggressive coupon and discount promotions to encourage volume reduced the average revenue per car. As to the decline in revenues from lube and other automotive services, we discontinued the practice of providing a free wash to lube customers, resulting in decreased lube revenues but benefitting our overall site gross margin performance. The decline in fuel and merchandise revenues is the result of instituting certain minimum gross margin criteria which reduced fuel sales and the sale of certain low margin merchandise.

### Security Products

During 2001 and for the first four months of 2002, pursuant to a Management Agreement, the Company was paid \$20,000 per month. This amount is included under revenues from operating agreements. Effective May 1, 2002, the Company recommenced operation of the Security Products Division. Revenues for the five months in which the Company operated this division, May through September of 2002, were approximately \$1.4 million. Additionally, in August 2002 the Company purchased the inventory and certain assets of Micro-Tech, an electronic security device business. Revenues for this business unit were approximately \$165,000 through September 30, 2002.

### Cost of Revenues

#### Car Care Services

Cost of revenues for the nine months ended September 30, 2002 were \$24.0 million or 71% of revenues with car washing and detailing costs at 69% of respective revenues, lube and other automotive services costs at 79% of respective revenues, and fuel and merchandise costs at 87% of respective revenues. Cost of revenues for the nine months ended September 30, 2001 were \$26.4 million, or 72% of revenues. With only a slight decrease in average wash and detailing revenues per car in 2002 and our continued emphasis on controlling direct labor and other operating costs such as wash and detailing chemicals and supplies, car

damages, uniform expense, and repairs and maintenance costs, we achieved improved wash and detailing gross margins in 2002. We reduced our direct wash and detailing labor costs as a percent of car wash and detail revenues to 46.9% in 2002 as compared to 47.7% in 2001.

### Security Products

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During 2001 and for the first four months of 2002, pursuant to a Management Agreement, no costs were incurred by us. Cost of revenues were \$868,000 or 55% of revenues for the five months in which the Company operated this division.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for the nine months ended September 30, 2002 were \$6.2 million compared to \$5.5 million for the same period in 2001, an increase of approximately \$0.7 million or 12%. SG&A costs as a percent of revenues were 17.4% for the nine months ended September 30, 2002 as compared to 14.9% in the same period of 2001. The increase in SG&A costs is primarily the result of recommencing operation of the Security Products Division in May 2002, which added \$550,000 of SG&A costs in 2002, combined with an increase in certain credit card and bank charges and a significant increase in insurance costs. This increase was partially offset by a decrease in administrative salaries and certain office costs.

### Depreciation and Amortization

Depreciation and amortization totaled \$1.5 million for the nine months ended September 30, 2002 as compared to \$2.0 million for the same period in 2001. This decrease is primarily attributable to the adoption of SFAS 142 on January 1, 2002, under which the Company no longer amortizes goodwill and other intangible assets determined to have indefinite useful lives. This decrease is partially offset by increased depreciation expense as a result of recommencing operation of the security products division in May 2002.

### Interest Expense, Net

Interest expense, net of interest income, for the nine months ended September 30, 2002, was \$1.7 million compared to \$2.3 million for the nine months ended September 30, 2001. This decrease in our interest expense is the result of a decrease in interest rates on approximately 50% of our long term debt which has interest rates tied to the prime rate and a reduction in our outstanding debt as a result of normal principal payments.

### Other Income

Other income for the nine months ended September 30, 2002 was \$230,000 compared to \$429,000 for the nine months ended September 30, 2001. The primary reason for the decrease is that the 2001 figure includes a \$216,000 gain on the sale of a car wash facility in August of 2001.

### Income Taxes

We recorded a tax expense of \$524,000 for the nine months ended September 30, 2002. Tax expense reflects the recording of income taxes on income before cumulative effect of a change in accounting principle at an effective rate of 36%. The effective rate differs from the federal statutory rate primarily due to state and local income taxes, non-deductible costs related to acquired intangibles, and the use of net operating loss carryforwards.

Results of Operations for the Three Months Ended September 30, 2002  
Compared to the Three Months Ended September 30, 2001

### Revenues

#### Car Care Services

Revenues for the three months ended September 30, 2002 were \$10.7 million as

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compared to \$10.9 million for the three months ended September 30, 2001, a decrease of \$.2 million or 2%. This decrease was primarily attributable to a decrease in wash and detail services. Of the \$10.7 million of revenues for the three months ended September 30, 2002, \$8.7 million or 82% was generated from car wash and detailing, \$1.1 million or 10% from lube and other automotive services, and \$0.9 or 8% from fuel and merchandise sales. Of the \$10.9 million of revenues for the three months ended September 30, 2001, \$8.9 million or 82 % was generated from car wash and detailing, \$1.1 million or 10% from lube and other automotive services, and \$0.9 million or 8% from fuel and merchandise sales. The decrease in wash and detailing revenues was principally due to a reduction in average

22

wash and detailing revenues per car to \$13.83 in the three months ended September 30, 2002 as compared to \$14.54 in the third quarter of 2001. This decrease in average wash and detailing revenues per car was partially offset by a slight increase in volume in the three months ending September 30, 2002, as compared to the same period in 2001. The revenue reduction is largely the result of more aggressive coupon and discount promotions to encourage volume increases to the car wash facilities.

### Security Products

During 2001 and for the first four months of 2002, pursuant to a Management Agreement, the Company was paid \$20,000 per month. This amount is included under revenues from operating agreements. Effective May 1, 2002, the Company recommenced operation of the Security Products Division. Revenues for the three months ended September 30, 2002 were \$1.0 million. Additionally, in August 2002 the Company purchased the inventory and certain assets of an electronic security device business. Revenues for this division were approximately \$165,000 through September 30, 2002.

### Cost of Revenues

#### Car Care Services

Cost of revenues for the three months ended September 30, 2002 were \$8.1 million or 75% of revenues with car washing and detailing costs at 74% of respective revenues, lube and other automotive services costs at 79% of respective revenues, and fuel and merchandise costs at 87% of respective revenues. Cost of revenues for the three months ended September 30, 2001 were \$8.1 million, or 75% of revenues.

#### Security Products

During 2001, pursuant to a Management Agreement, no costs were incurred by us. During the three months ended September 30, 2002, cost of revenues were \$643,000 or 55% of revenues.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for the three months ended September 30, 2002 were \$2.3 million compared to \$1.7 million for the same period in 2001, an increase of approximately \$0.6 or 35%. SG&A costs as a percent of revenues were 19.6% for the three months ended September 30, 2002 as compared to 15.7% in the third quarter of 2001. The increase in SG&A costs is primarily the result of recommencing operation of the Security Products Division in May 2002, which added \$347,000 of SG&A costs in 2002, combined with an increase in certain credit card and bank charges and a significant increase in

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insurance costs. This increase was partially offset by a decrease in administrative salaries and certain office costs.

### Depreciation and Amortization

Depreciation and amortization totaled \$474,000 for the three months ended September 30, 2002 as compared to \$684,000 for the same period in 2001. This decrease is primarily attributable to the adoption of SFAS 142 on January 1, 2002, under which the Company no longer amortizes goodwill and other intangible assets determined to have indefinite useful lives. This decrease is partially offset by increased depreciation expense as a result of recommencing operation of the security products division in May 2002.

### Interest Expense, Net

Interest expense, net of interest income, for the three months ended September 30, 2002, was \$553,000 compared to \$712,000 for the three months ended September 30, 2001. This decrease in our interest expense is the result of a decrease in interest rates on approximately 50% of our long term debt which has interest rates tied to the prime rate and a reduction in our outstanding debt as a result of normal principal payments.

### Other Income

Other income for the three months ended September 30, 2002 was \$82,000 compared to \$289,000 for the three months ended September 30, 2001. The primary reason for the decrease is that the 2001 figure includes a \$216,000 gain on the sale of a car wash facility in August 2001.

23

### Income Taxes

We recorded a tax benefit of \$65,000 for the three months ended September 30, 2002. This tax benefit reflects the recording of income taxes or income before cumulative effect of a change in accounting principle at an effective rate of 36%. The effective rate differs from the federal statutory rate primarily due to state and local income taxes, non-deductible costs related to acquired intangibles, and the use of net operating loss carryforwards.

### Risk Factors

We need to raise additional capital. Additional capital will be needed if acquisitions of car washes or other businesses are made. Our capital requirements also include working capital for daily operations and capital for equipment purchases. To the extent that we lack cash to meet our future capital needs, we will be required to raise additional funds through bank borrowings and additional equity and/or debt financing, which may result in significant increases in leverage and interest expense and/or substantial dilution. If we are unable to raise additional capital, we will need to curtail future acquisitions.

Risks of Acquisitions and New Business Segments. One of our strategies has been to grow through acquisitions. We are currently examining acquisition candidates in the security products and the car care industry. To the extent we make acquisitions, our ability to identify suitable acquisition candidates, understand new businesses, and consummate acquisitions on financially favorable terms is a risk. Acquisitions involve risks inherent in assessing acquisition candidates' values, strengths, weaknesses, risks and profitability and risks related to the financing, integration and operation of acquired businesses,

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including:

- i. adverse short-term effects on our reported operating results;
- ii. diversion of management's attention;
- iii. dependence on hiring, training and retaining key personnel;
- iv. risks associated with unanticipated problems or latent liabilities; and
- v. risks inherent with management not having experience in new business segments acquired.

We cannot give assurance that acquisition opportunities will be available, that we will have access to the capital required to finance potential acquisitions, that we will continue to acquire businesses, or that any acquired business will be profitable.

Listing on the Nasdaq National Market. On October 2, 2002, the Company was advised by Nasdaq that its common stock has failed to maintain a minimum bid price of \$1.00 over the last 30 consecutive trading days as required by the Nasdaq National Market under Marketplace Rules. The Company has been provided 90 calendar days, or until December 31, 2002, to regain compliance with the Marketplace Rules by maintaining a bid price of the Company's common stock of at least \$1.00 for a minimum of 10 consecutive trading days (or longer, at the discretion of Nasdaq). If the Company is unable to demonstrate compliance with the rule on or before December 31, 2002, Nasdaq will provide the Company with written notification that its securities will be delisted. The Company may appeal such a decision to a Nasdaq Listing Qualifications Panel, or it may apply to transfer its securities to the Nasdaq SmallCap Market ("SmallCap Market"). To transfer, the Company must satisfy the continued inclusion requirements for the SmallCap Market, which makes available an extended grace period for the minimum \$1.00 bid price requirement. If the transfer application is submitted by December 31, 2002 and if the application is approved, the Company will be afforded the 180 calendar day SmallCap Market grace period or until March 31, 2003. The Company may also be eligible for an additional 180 calendar day grace period provided that it meets the initial listing criteria for the SmallCap Market under Marketplace Rules. Furthermore, the Company may be eligible to transfer back to the Nasdaq National Market if, by September 29, 2003, its bid price maintains the \$1.00 per share requirement for 30 consecutive trading days and it has maintained compliance with all other continued listing requirements on that market.

In the event we are delisted from the Nasdaq SmallCap Market, our stock may be traded over-the-counter, more commonly known as OTC. OTC transactions involve risks in addition to those associated with transactions in securities traded on the Nasdaq National Market or the Nasdaq SmallCap Market (together "Nasdaq-Listed Stocks"). OTC companies may have limited product lines, markets or financial resources. Many OTC stocks trade less frequently and in smaller volumes than Nasdaq-Listed Stocks. The values of these stocks may be more volatile than Nasdaq-Listed Stocks. If our stock is traded in the OTC market and a market maker sponsors us, we may have the price of our stock electronically displayed on the OTC Bulletin Board, or OTCBB. However, if we lack sufficient market maker support for display on the OTCBB, we must have our price published by the National Quotations Bureau LLP in a paper publication known as the "Pink Sheets." The marketability of our stock will be even more limited if our price must be published on the "Pink Sheets."

If our common stock regains compliance with the Marketplace Rules by December 31, 2002, it will still be subject to delisting if the stock does not maintain a minimum bid price of one dollar for thirty consecutive days after coming into compliance. If our stock is under \$1.00 for thirty consecutive business days, we will be able to maintain our listing if during the next 90 day period, our stock maintains at least a minimum bid price of \$1.00 for a ten consecutive day period. The ten day period required can be

extended at the discretion of Nasdaq. In the event we are delisted from the Nasdaq National Market, our stock would be traded on the Nasdaq SmallCap Market until we maintain a minimum bid price of one dollar for thirty consecutive days at which time we can regain listing on the Nasdaq National Market. If our stock does not maintain a minimum bid price of one dollar for thirty consecutive days during a 180 day grace period on the Nasdaq SmallCap Market or a 360 day grace period if compliance with certain core listing standards are demonstrated, we will receive a delisting notice from the Nasdaq SmallCap Market.

We have reported net losses in the past. We have reported net losses and working capital deficits in the past, and we have expended substantial funds for acquisitions and equipment. With the adoption of SFAS 142 on January 1, 2002, we no longer amortize goodwill and certain intangible assets determined to have indefinite useful lives. Additionally, SFAS 142 requires annual fair value based impairment tests of goodwill and other intangible assets identified with indefinite useful lives. The Company cannot guarantee that there will not be impairments in a subsequent quarter in 2002 or in subsequent years that will have a material impact on earnings and equity of the Company. (See also Note 3, Change in Accounting Principle.)

Risk related to borrowings. In connection with our operations and business growth, we anticipate that we will continue to have significant debt and interest charges. Several of our debt agreements, as amended, contain certain affirmative and negative covenants and require the maintenance of certain levels of tangible net worth and the maintenance of certain debt coverage ratios on an individual subsidiary and consolidated level. If our results are not sufficient to maintain the required ratios, we would be in default of our loan agreements.

Our business plan poses risks for us. One of our business objectives is to continue to develop as a full service, integrated car care business through acquisitions and through the internal development of our car wash facilities. Our business plan is to also grow our consumer security products division through acquisitions and internal development of security products. This strategy involves a number of risks, including:

- i. risks associated with growth;
- ii. risks associated with acquisitions; and
- iii. risks associated with the recruitment and development of management and operating personnel.

If we are unable to manage one or more of these associated risks effectively, we may not fully realize our business plan.

We have a limited operating history regarding some of our business segments. We recently expanded our security products by adding a digital camera and recorder product line. We are incurring expenses to develop the new line without having tested the size of the market of the new line.

We may not be able to manage growth. If we succeed in growing, growth will place significant burdens on our management and on our operational and other resources. We will need to attract, train, motivate, retain and supervise our senior managers and other employees. If we are unable to do this, we will not be able to realize our business objectives.

Our car wash business may suffer under certain weather conditions. Seasonal trends in some periods may affect our car wash business. In particular, long periods of rain and cloudy weather can adversely affect our car wash business as



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people typically do not wash their cars during such periods. Additionally, extended periods of warm, dry weather may encourage customers to wash their cars themselves which also can adversely affect our car wash business.

Our stock price is volatile. Our common stock's market price has been and is likely to continue to be highly volatile. Factors like fluctuations in our quarterly revenues and operating results, our ongoing acquisition program, market conditions and economic conditions generally may impact significantly our common stock's market price. In addition, if we make an acquisition, we may agree to issue common stock that will become available generally for resale and may have an impact on our common stock's market price.

We may not be able to integrate businesses we acquire. Our strategy is to achieve economies of scale and brand name recognition in part through acquisitions that increase our size. We cannot give assurance that we will be able to acquire businesses or that our efforts to integrate acquired operations will be effective or that we will realize expected results. Our failure to achieve any of these results could have a material adverse effect on our business and results of operations.

We face potential liabilities associated with acquisitions of businesses. The businesses we acquire may have liabilities that we do not discover or may be unable to discover during our preacquisition investigations, including liabilities arising from environmental contamination or prior owners' non-compliance with environmental laws or other regulatory requirements, and for which we, as a successor owner or operator, may be responsible.

25

We face risks associated with our consumer safety products. We face claims of injury allegedly resulting from our defense sprays. We cannot give assurance that our insurance coverage will be sufficient to cover any judgments won against us in these lawsuits. If our insurance coverage is exceeded, we will have to pay the excess liability directly. We are also aware of several claims that defense sprays used by law enforcement personnel resulted in deaths of prisoners and of suspects in custody. While we no longer sell defense sprays to law enforcement agencies, it is possible that the increasing use of defense sprays by the public could, in the future, lead to additional product liability claims.

Consumer demand for our car wash services is unpredictable. Our financial condition and results of operations will depend substantially on consumer demand for car wash services. Our business depends on consumers choosing to employ professional services to wash their cars rather than washing their cars themselves or not washing their cars at all. We cannot give assurance that consumer demand for car wash services will increase as our business expands. Nor can we give assurance that consumer demand will maintain its current level.

We must maintain our car wash equipment. Although we undertake to keep our car washing equipment in proper operating condition, the operating environment found in car washes results in frequent mechanical problems. If we fail to adequately maintain our sites, we would lose volume resulting in a loss of revenue.

Our car wash and car care services operations face governmental regulations. We are governed by federal, state and local laws and regulations, including environmental regulations, that regulate the operation of our car wash centers and other car care services businesses. Car wash centers utilize cleaning agents and waxes in the washing process that are then discharged in waste water along with oils and fluids washed off of vehicles. Other car care

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services, such as gasoline and lubrication, use a number of oil derivatives and other regulated hazardous substances. As a result, we are governed by environmental laws and regulations dealing with, among other things:

- i. transportation, storage, presence, use, disposal and handling of hazardous materials and hazardous wastes;
- ii. discharge of stormwater; and
- iii. underground storage tanks.

If any of the previously mentioned substances were found on our property, including leased property, or if we were found to be in violation of applicable laws and regulations, we could be responsible for clean-up costs, property damage and fines or other penalties, any one of which could have a material adverse effect on our financial condition and results of operations.

We face significant competition in the car care segment. The extent and kind of competition that we face varies. The car care industry is highly competitive. Competition is based primarily on location, facilities, customer service, available services and rates. Because barriers to entry into the car care industry are relatively low, competition may be expected to continually arise from new sources not currently competing with us. We also face competition from outside the car care industry, such as gas stations and convenience stores, that offer automated car wash services. In some cases, these competitors may have greater financial and operating resources than we have. In our car wash businesses, we face competition from a number of sources, including regional and national chains, gasoline stations, gasoline companies, automotive companies and specialty stores, both regional and national.

Our operations are dependent substantially on the services of our executive officers. If we lose one or more of our executive officers, the loss could have a material adverse effect on our business and results of operations. We do not maintain key-man life insurance policies on our executive officers.

Our preferred stock may affect the rights of the holders of our common stock; it may also discourage another entity from acquiring control of Mace. Our Certificate of Incorporation authorizes the issuance of up to 10,000,000 shares of preferred stock. No shares of preferred stock are currently outstanding. It is not possible to state the precise effect of preferred stock upon the rights of the holders of our common stock until the Board of Directors determines the respective preferences, limitations and relative rights of the holders of one or more series or classes of the preferred stock. However, such effect might include: (i) reduction of the amount otherwise available for payment of dividends on common stock, to the extent dividends are payable on any issued shares of preferred stock, and restrictions on dividends on common stock if dividends on the preferred stock are in arrears, (ii) dilution of the voting power of the common stock to the extent that the preferred stock has voting rights, and (iii) the holders of common stock not being entitled to share in our assets upon liquidation until satisfaction of any liquidation preference granted to the preferred stock.

The preferred stock may be viewed as having the effect of discouraging an unsolicited attempt by another entity to acquire control of us and may therefore have an anti-takeover effect. Issuances of authorized preferred stock can be implemented, and have been implemented by some companies in recent years with voting or conversion privileges intended to make an acquisition of the

company more difficult or costly. Such an issuance could discourage or limit the stockholders' participation in certain types of transactions that might be

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proposed (such as a tender offer), whether or not such transactions were favored by the majority of the stockholders, and could enhance the ability of officers and directors to retain their positions.

Some provisions of Delaware law may prevent us from being acquired. We are governed by Section 203 of the Delaware General Corporation Law, which prohibits a publicly held Delaware corporation from engaging in a "business combination" with an entity who is an "interested stockholder" for a period of three (3) years, unless approved in a prescribed manner. This provision of Delaware law may affect our ability to merge with, or to engage in other similar activities with, some other companies. This means that we may be a less attractive target to a potential acquirer who otherwise may be willing to pay a price for our common stock above its market price.

We do not expect to pay cash dividends on our common stock. We do not expect to pay any cash dividends on our common stock in the foreseeable future. We will reinvest in our business any cash otherwise available for dividends.

There are additional risks set forth in the incorporated documents. In addition to the risk factors set forth above, you should review the financial statements and exhibits incorporated into this report. Such documents may contain, in certain instances and from time to time, additional and supplemental information relating to the risks set forth above and/or additional risks to be considered by you, including, without limitation, information relating to losses experienced by us in certain historical periods, working capital deficits at particular dates, information relating to pending and recently completed acquisitions, descriptions of new or changed federal or state regulations applicable to Mace, data relating to remediation and the actions taken by Mace, and estimates at various times of Mace's potential liabilities for compliance with environmental laws or in connection with pending litigation.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in our exposure to market risks arising from fluctuations in foreign currency exchange rates, commodity prices, equity prices or market interest rates since December 31, 2001 as reported on our Form 10-K for the year ended December 31, 2001.

### Item 4. Controls and Procedures

At the beginning of the third quarter of 2002, in response to recent legislation and additional requirements, an evaluation of the effectiveness of the Company's internal control structure and disclosure controls and procedures was conducted under the supervision of, and reviewed by, the Company's Chief Executive Officer and Chief Financial Officer. As a result of such review, we implemented changes, primarily to formalize and document the procedures already in place. We have designed our disclosure controls and procedures to ensure that material information related to the Company, including our consolidated subsidiaries, is made known to our disclosure committee, including our Chief Executive Officer and Chief Financial Officer on a regular basis, in particular during the period in which periodic reports under the Securities Exchange Act of 1934 are being prepared. As required, we will evaluate the effectiveness of these disclosure controls and procedures on a quarterly basis, and did so on October 9, 2002, a date within 90 days prior to the filing of this quarterly report. We believe as of that date, such controls and procedures were operating effectively and as designed. Refer to the certifications by the Company's Chief Executive Officer and Chief Financial Officer following the signature page of this report.

We presented the results of our most recent evaluation of our disclosure controls and procedures to the Audit Committee of the Board of Directors. Based on such evaluation, the Company's management, including our Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure

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controls and procedures are adequate to insure the clarity and material completeness of the Company's disclosure in its periodic reports required to be filed with the SEC and there are no significant deficiencies in the design or operation of internal controls which could significantly affect our ability to record, process, summarize and report financial data.

### PART II OTHER INFORMATION

#### Item 1. Legal Proceedings

Information regarding our legal proceedings can be found in Note 7, Commitments and Contingencies, to the consolidated financial statements.

27

#### Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of the Stockholders of Mace Security International, Inc. was held on September 12, 2002. The following proposals were submitted to a vote: (i) to approve for a one-year term the Election of Directors, expiring at the next Annual Meeting, and (ii) to ratify the appointment of Grant Thornton LLP as Mace's independent auditors for fiscal year 2002. Both proposals were adopted by the shareholders. The voting was as follows:

|   | Votes For<br>----- | Votes With-<br>held or Against<br>----- | Abstentions<br>----- | Broker<br>Non-Votes<br>----- |
|---|--------------------|---|----------------------|------------------------------|
| <b>Directors:</b>                               |                    |   |                      |                              |
| -----   |                    |   |                      |                              |
| Louis D. Paolino, Jr.                           | 22,129,784         | 500,907                                 | -                    | -                            |
| Mark S. Alsentzer                               | 22,010,996         | 619,695                                 | -                    | -                            |
| Jon E. Goodrich                                 | 22,169,784         | 460,907                                 | -                    | -                            |
| Robert M. Kramer                                | 22,169,784         | 460,907                                 | -                    | -                            |
| Richard B. Muir                                 | 22,169,784         | 460,907                                 | -                    | -                            |
| Matthew J. Paolino                              | 22,129,784         | 500,907                                 | -                    | -                            |
| Constantine N. Papadakis, Ph.D.                 | 22,169,784         | 460,907                                 | -                    | -                            |
| <br>Ratify appointment of Grant<br>Thornton LLP | <br>22,553,511     | <br>58,520                              | <br>18,660           | <br>-                        |

#### Item 5. Other Information

In addition to the Chief Executive Officer and Chief Financial Officer Certifications required by Section 302 of the Sarbanes-Oxley Act which are attached to this report following the signature page, the Company has submitted to the Securities and Exchange Commission as correspondence accompanying this report the Chief Executive Officer and Chief Financial Officer Certifications required by Section 906 of that Act.

#### Item 6. Exhibits and Reports on Form 8-K

##### (a) Exhibits:

\*10.143 Asset Purchase Agreement dated as of August 12, 2002, by and among Micro-Tech Manufacturing, Inc. and Moshe Luski

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on the one hand, and Mace Security Products, Inc., a wholly owned subsidiary of Mace Security International, Inc.

10.144 Lease Schedule and Addendum dated August 28, 2002 in the amount of \$39,434 to Master Lease Agreement dated June 10, 2002, between the Company, its subsidiary, Colonial Full Service Car Wash, Inc., and Banc One Leasing Corporation.

\* Incorporated by reference as indicated in the Company's current report on Form 8-K.

(b) Current Reports on Form 8-K or 8-K/A:

On August 14, 2002, the Company filed a report on Form 8-K dated August 14, 2002, under Item 9, to report the submission in conjunction with the filing of the Company's Form 10-Q for the quarter ended June 30, 2002, unqualified certificates as required under Section 906 of the Sarbanes-Oxley Act of 2002.

On August 22, 2002, the Company filed a report on Form 8-K dated August 12, 2002, under Item 2 to report the acquisition of the assets of Micro-Tech Manufacturing, Inc. by Mace Security Products, Inc., a wholly owned subsidiary of the Company. In accordance with the applicable regulations under the Securities and Exchange Act of 1934, the Company has concluded that Securities and Exchange Act rules do not require the filing of financial statements with respect to the acquired company.

28

SIGNATURES

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

Mace Security International, Inc.

BY: /s/ Louis D. Paolino, Jr.

-----  
Louis D. Paolino, Jr., Chairman, Chief Executive Officer and President

BY: /s/ Gregory M. Krzemien

-----  
Gregory M. Krzemien, Chief Financial Officer

BY: /s/ Ronald R. Pirollo

-----  
Ronald R. Pirollo, Controller (Principal Accounting Officer)

DATE: November 12, 2002

29

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### CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Louis D. Paolino, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Mace Security International, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

/s/ Louis D. Paolino, Jr.  
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Louis D. Paolino, Jr.  
Chief Executive Officer and President

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30

### CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Gregory M. Krzemien, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Mace Security International, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 12, 2002

/s/ Gregory M. Krzemien

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Gregory M. Krzemien  
Chief Financial Officer and Treasurer

31

EXHIBIT INDEX

| Exhibit No.<br>----- | Description<br>-----  |
|----------------------|---|
| 10.144               | Lease Schedule and Addendum dated August 28, 2002 in the amount of \$39,434 to Master Lease Agreement dated June 10, 2002, between the Company, its subsidiary, Colonial Full Service Car Wash, Inc., and Banc One Leasing Corporation. |

32