

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

MACE SECURITY INTERNATIONAL INC  
Form 10-Q  
August 14, 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 JUNE 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 August 9, 2002, there were 25,349,027 Shares of Registrant's Common Stock, par value \$.01 per share, outstanding.

Mace Security International, Inc.

Form 10-Q  
Quarter Ended June 30, 2002

Contents

PART I - FINANCIAL INFORMATION

Item 1 - Financial Statements

Page

2

1

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

Consolidated Balance Sheets - June 30, 2002 (Unaudited) and December 31, 2001	2
Consolidated Statements of Operations for the three months ended June 30, 2002 and 2001 (Unaudited)	4
Consolidated Statements of Operations for the six months ended June 30, 2002 and 2001 (Unaudited)	5
Consolidated Statement of Stockholders' Equity  for the six months ended June 30, 2002 (Unaudited)	6
Consolidated Statements of Cash Flows for the  six months ended June 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	14
Item 3 - Qualitative and Quantitative Disclosures about Market Risk	24
PART II - OTHER INFORMATION	
Item 1 - Not applicable	-
Item 2 - Not applicable	-
Item 3 - Not applicable	-
Item 4 - Not applicable	-
Item 5 - Not applicable	-
Item 6 - Exhibits and Reports on Form 8-K	25

1

### PART I FINANCIAL INFORMATION

#### Item 1. Financial Statements

Mace Security International, Inc.

Consolidated Balance Sheets

(In thousands except share information)

June 30,

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

ASSETS	2002	
	-----	-----
	(Unaudited)	
Current assets:		
Cash and cash equivalents	\$ 7,605	
Accounts receivable, less allowance for doubtful accounts of \$213 and \$178 in 2002 and 2001, respectively	719	
Inventories	2,373	
Deferred income taxes	152	
Prepaid expenses and other current assets	1,709	
	-----	-----
Total current assets	12,558	
Property and equipment:		
Land	32,029	
Buildings and leasehold improvements	36,637	
Machinery and equipment	9,138	
Furniture and fixtures	444	
	-----	-----
Total property and equipment	78,248	
Accumulated depreciation and amortization	(8,178)	
	-----	-----
Total property and equipment, net of accumulated depreciation and amortization	70,070	
Goodwill, net of accumulated amortization of \$2,031	20,139	
Other intangible assets, net of accumulated amortization of \$1,397 and \$1,384 in 2002 and 2001, respectively	915	
Other assets	305	
	-----	-----
Total assets	\$103,987	=====

See accompanying notes.

2

LIABILITIES AND STOCKHOLDERS' EQUITY	June 30,	De
	2002	-----
	(Unaudited)	-----
Current liabilities:		
Current portion of long term debt and capital lease obligations	\$ 6,787	\$
Accounts payable	1,830	
Income taxes payable	85	
Deferred revenue	214	
Accrued expenses and other current liabilities	2,138	
	-----	-----
Total current liabilities	11,054	
Deferred income taxes	1,125	
Long term debt, net of current portion	26,670	

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

Capital lease obligations, net of current portion	359	
Other liabilities	-	
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 25,349,027 and 25,428,427 in 2002 and 2001, respectively	253	
Additional paid in capital	69,897	
Accumulated deficit	(5,371)	
	-----	-----
Total stockholders' equity	64,779	
	-----	-----
Total liabilities and stockholders' equity	\$ 103,987	\$
	=====	=====

See accompanying notes.

3

Mace Security International, Inc.

Consolidated Statements of Operations  
(Unaudited)

(In thousands except share information)

		Three Mo Jun
		----- 2002 -----
Revenues:		
Car wash and detailing services	\$	9,556
Lube and other automotive services		1,007
Fuel and merchandise sales		873
Security products sales		397
Operating agreements		20
		-----
		11,853
Cost of revenues:		
Car wash and detailing services		6,460
Lube and other automotive services		833
Fuel and merchandise sales		754
Security products sales		225
		-----
		8,272
Selling, general and administrative expenses		2,042
Depreciation and amortization		510

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

Costs of terminated acquisitions

	-----
Operating income	1,029
Interest expense, net	(553)
Other income	82
	-----
Income before income taxes	558
Income tax expense	201
	-----
Net income	\$ 357
	=====
Per share of common stock:	
Basic	\$ 0.01
	=====
Diluted	\$ 0.01
	=====
Weighted average shares outstanding:	
Basic	25,349,027
Diluted	25,423,145

See accompanying notes.

4

Mace Security International, Inc.  
 Consolidated Statements of Operations  
 (Unaudited)  
 (In thousands except share information)

	-----
	Six Mon
	Jun
	-----
	2002
	-----
Revenues:	
Car wash and detailing services	\$ 19,522
Lube and other automotive services	2,043
Fuel and merchandise sales	1,568
Security products sales	397
Operating agreements	80
	-----
	23,610
Cost of revenues:	

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

Car wash and detailing services	12,986
Lube and other automotive services	1,622
Fuel and merchandise sales	1,355
Security products sales	225
	-----
	16,188
Selling, general and administrative expenses	3,835
Depreciation and amortization	982
Cost of terminated acquisitions	-
	-----
Operating income	2,605
Interest expense, net	(1,116)
Other income	147
	-----
Income before income taxes and cumulative effect of a change in accounting principle	1,636
Income tax expense	589
	-----
Income before cumulative effect of a change in accounting principle	1,047
Cumulative effect of a change in accounting principle, net of tax	43
	-----
Net income	\$ 1,004
	=====
Per share of common stock:	
Basic income before cumulative effect of a change in accounting principle	\$ 0.04
Cumulative effect of a change in accounting principle, net of tax	-
	-----
Basic net income	\$ 0.04
	=====
Diluted income before cumulative effect of a change in accounting principle	\$ 0.04
Cumulative effect of a change in accounting principle, net of tax	-
	-----
Diluted net income	\$ 0.04
	=====
Weighted average shares outstanding:	
Basic	25,367,786
Diluted	25,430,189

See accompanying notes.

5

Mace Security International, Inc.

Consolidated Statement of Stockholders' Equity  
(Unaudited)

(In thousands except share information)

Number of Par Value Additional

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

	Common Shares	of Common Stock	Paid-in Capital	Accumulat Defici
	-----	-----	-----	-----
Balance at December 31, 2001	25,428,427	\$ 254	\$ 69,977	\$ (6,
Shares purchased and retired	(79,400)	(1)	(80)	
Net income				1,
	-----	-----	-----	-----
Balance at June 30, 2002	25,349,027	\$ 253	\$ 69,897	\$ (5,
	=====	=====	=====	=====

See accompanying notes.

6

Mace Security International, Inc.  
Consolidated Statements of Cash Flows  
(Unaudited)

(In thousands)

	-----
	2002
	-----
Operating activities	
Net income	\$ 1,004
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	982
Provision for losses on receivables	32
Deferred income taxes	479
Non-cash charge due to change in accounting principle	67
Changes in operating assets and liabilities:	
Accounts receivable	103
Inventories	(110)
Accounts payable	(569)
Deferred revenue	(39)
Accrued expenses	4
Income taxes	(89)
Prepaid expenses and other assets	603
	-----
Net cash provided by operating activities	2,467
Investing activities	
Purchase of property and equipment	(310)
Proceeds from sale of property and equipment	-
Payments for intangibles	(2)
Deposits and other prepaid costs on future acquisitions	(14)
	-----
Net cash used in investing activities	(326)

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

Financing activities	
Payments on long-term debt and capital lease obligations	(1,067)
Payments to purchase stock	(81)
	-----
Net cash used in financing activities	(1,148)
	-----
Net increase in cash and cash equivalents	993
Cash and cash equivalents at beginning of period	6,612
	-----
Cash and cash equivalents at end of period	\$ 7,605
	=====

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 six month periods ended June 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 separately from goodwill if they arise from contractual or other legal



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

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 required 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 step of the goodwill transitional impairment testing was completed during the second quarter of 2002 and as of December 31, 2001, the transition date (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. The application of this Statement is not limited to certain specialized industries, such as the extractive or nuclear industries. This Statement also applies, for example, to a company that operates a manufacturing facility and has a legal obligation to dismantle the manufacturing plant and restore the underlying land when it ceases operation of that plant. A liability for an asset retirement obligation should be recognized if the obligation meets the definition of a liability and can be reasonably estimated. The initial recording should be at fair value. SFAS 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002, with earlier application encouraged. 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

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

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.

### 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, the Company performed its first phase of 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 relative to 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 SFAS 142 as if it were adopted on January 1, 2001 (in thousands except earnings per share):

	Three Months Ended June 30,		
	2002	2001	
Net income, as reported	\$ 357	\$ 358	\$
Add back: amortization expense, net of tax	-	140	
Pro forma net income	\$ 357	\$ 498	\$
Basic earnings per common share:			
As reported	\$ 0.01	\$ 0.01	\$
Pro forma	\$ 0.01	\$ 0.02	\$
Diluted earnings per common share:			
As reported	\$ 0.01	\$ 0.01	\$
Pro forma	\$ 0.01	\$ 0.02	\$

Under the provisions of SFAS 142, the Company is also required to perform a transitional goodwill impairment test within six months of adopting the new standard and to test for impairment on at least an annual basis thereafter. In performing the first step of the transitional testing, we determined our reporting units and estimated the fair values of the reporting units using a discounted cash flow model. The Company engaged an independent appraisal firm to derive appropriate discount rates for each reporting unit using the weighted average cost of capital technique to utilize in the Company's 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. We compared the fair value of each reporting unit to its respective carrying value,

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

including related goodwill. As of December 31, 2001, the transition date, it was determined through the first step of the transitional test, that there is potential impairment in the Arizona reporting unit of \$5.3 million and in the truck wash reporting unit of \$670,000. Additionally, it was determined that there is a potential impairment in the Northeast reporting unit of \$1.1 million. Because the carrying values of the net assets of each of these reporting units (including goodwill) exceed the respective fair values of the reporting units, the second step of the transitional goodwill impairment test must be completed to determine the amount of the impairment. We must complete the second step no later than by the end of December 31, 2002, but we anticipate completing that step during the third quarter of 2002. In no event will the impairment of these reporting units exceed \$12.5 million, which is the amount of goodwill assigned to these reporting units.

9

#### 4. Other Intangible Assets

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

	June 30, 2002		
	Gross Carrying Amount	Accum. Amort.	Gross Carrying Amount
Amortized intangible assets:			
Deferred financing costs	\$ 361	\$ 117	\$
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	\$ 2,312	\$ 1,397	\$

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

2002	\$25
2003	19
2004	18
2005	18
2006	18

#### 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

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

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.

### 6. Operating Agreement

The Company entered into a Management Agreement with Mark Sport, Inc. ("Mark Sport"), a Vermont corporation. Mark Sport is 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 Agreement was extended through April 30, 2002. In exchange, Mark Sport paid the Company \$20,000 per month through the term of the Management Agreement as extended. Additionally, Mark Sport was required to pay the Company an amount equal to the amortization and depreciation on the assets of the division at the end of the term of the Agreement. During the term of the Agreement, Mark Sport was required to operate the division in substantially the same manner as it was operated prior to the Management Agreement. On April 30, 2002, the Management Agreement with Mark Sport expired. The Company is currently operating the Security Products Division. Accordingly, the results of operations of the Security Products Division from May 1, 2002 through June 30, 2002 are included in the consolidated statements of operations for the three and six months ended June 30, 2002 (See Note 11, Related Party Transactions).

### 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 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.

10

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 on 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 and

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

expects to obtain a judgement and collect on the note.

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, which may have been manufactured or sold by the Company. 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 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 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 Care	Security Products
	-----	-----
	(In Thousands)	
Three months ended June 30, 2002		
Revenues from external customers	\$ 11,436	\$ 41
Intersegment revenues	-	
Segment income (loss)	\$ 380	\$ (2)
Segment assets	\$ 100,477	\$ 3,51
Six months ended June 30, 2002		
Revenues from external customers	\$ 23,133	\$ 47
Intersegment revenues	-	
Segment income (loss)	\$ 1,032	\$ (2)
Three months ended June 30, 2001		
Revenues from external customers	\$ 12,982	\$ 6
Intersegment revenues	-	
Segment income	\$ 320	\$ 3
Six months ended June 30, 2001		
Revenues from external customers	\$ 25,751	\$ 12
Intersegment revenues	-	
Segment income	\$ 584	\$ 7

## 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 receivable and inventory valuation allowances 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 tax expense of \$201,000 and \$589,000 for the three and six

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

months ended June 30, 2002, respectively. Tax expense reflects the recording of income taxes 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. 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

12

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 Company's Chairman, Chief Executive Officer and President. The Company paid \$60,000 in fiscal 2001 and \$20,435 through June 30, 2002 for such services. An additional \$15,000 was paid in 2001 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 2001, the Company hired Premier Concrete, Inc., a company controlled by Matthew J. Paolino, the Company's Vice President and a director, to assist with underground tank removal and complete pavement re-surfacing at one of the Company's car wash locations. Premier Concrete, Inc., the lowest responsible bidder for the contract, was paid \$34,450 for its services in 2001. The Company believes that the rates charged are competitive when compared with similar service provided by independent contractors.

In February 2000, the Company entered into a Management Agreement with Mark

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

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 June 30, 2002, prior to the payment of \$100,000 on July 31, 2002 and resolution of disputes in the amount of \$39,000, Mark Sport owed the Company \$266,000.

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.

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 June 30, 2002, the balance owed on this promissory note was \$199,701.

13

### 12. Earnings Per Share

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



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

	Three Months Ended		Six Months Ended	
	6/30/02	6/30/01	6/30/02	6/30/01
Numerator:				
Net income (in thousands)	\$ 357	\$ 358	\$ 1,004	\$ 1,004
Denominator:				
Denominator for basic income per share - weighted average shares	25,349,027	25,452,935	25,367,786	25,367,786
Dilutive effect of options and warrants	74,118	58,411	62,403	62,403
Denominator for diluted income per share - weighted average shares	25,423,145	25,511,346	25,430,189	25,430,189
Basic income per share	\$ 0.01	\$ 0.01	\$ 0.04	\$ 0.04
Diluted income per share	\$ 0.01	\$ 0.01	\$ 0.04	\$ 0.04

13. Subsequent Events

Subsequent to June 30, 2002, the Company acquired the inventory, certain other assets and the operations of 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 as verified at closing by the Company, \$15,625 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. The transaction will be accounted for using the purchase method of accounting.

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

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

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.

### 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

14

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.

#### 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.

#### 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

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

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, 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 step of the transitional impairment testing was completed during the second 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 subsequent quarters 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 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.

### 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.

15

### 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 and ticket books sold at its car care locations but not yet redeemed. The Company estimates these unredeemed amounts based on gift certificates and ticket book sales and redemptions throughout the year as well as utilizing historical sales and

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

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 six months ended June 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.

Weather can have a significant impact on volume at the individual locations. However, we believe that the geographic diversity of our operating locations minimizes 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, 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 Division. The Company operates its security products segment in two main divisions, the Consumer Division and the Mace Anti-Crime Bureau Division. The Company's Consumer Division manufactures and markets personal safety, and home and auto security products which are sold through retail stores, major discount stores, and at the Company's car care facilities. The Mace Anti-Crime Bureau Division provides expertise in developing and producing criminal deterrent systems for government and law enforcement agencies, and financial institutions.

#### 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 Division was operated under a Management Agreement by Mark Sport. Accordingly, during that time, no costs were incurred by the Company. Beginning in May of

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

2002, cost of

16

revenues consists primarily of costs to manufacture the security products including direct labor and related taxes and benefits, and raw material costs.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of management, clerical and administrative salaries, professional services, insurance premiums, and 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 June 30, 2002, capitalized costs related directly to proposed acquisitions that were not yet consummated were approximately \$14,000. We periodically review the future likelihood of these 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 and Expense

Other income and expense 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.

### 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:

Six Months En  
June 30,  
-----

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

	2002
	-----
Revenues	100.0%
Cost of revenues	68.6
Selling, general and administrative expenses	16.2
Depreciation and amortization	4.2
Costs of terminated acquisitions	-
	-----
Operating income	11.0
Interest expense, net	(4.7)
Other income	0.6
	-----
Income before income taxes and cumulative effect of change in accounting principle	6.9
Income tax expense	2.5
	-----
Income before cumulative effect of a change in accounting principle	4.4
Cumulative effect of a change in accounting principle, net of tax	0.2
	-----
Net income	4.2%
	=====

17

#### Liquidity and Capital Resources

Our business requires substantial amounts of capital, most notably to pursue our acquisition strategies and for equipment purchases and upgrades. We plan to meet these capital needs from various financing sources, including borrowings, internally generated funds, and the issuance of common stock as the market price of the Company's stock improves.

As of June 30, 2002, we had working capital of approximately \$1.5 million and cash and cash equivalents of \$7.6 million. Working capital was \$4.8 million at December 31, 2001. The decrease in working capital at June 30, 2002 is primarily attributable to the reclassification of approximately \$4.7 million of 15 year amortizing loans from long term to current liabilities as a result of such loans being due in February 2003. The Company intends to renew these loans with the current lender. For the six months ended June 30, 2002, net cash provided by operations was approximately \$2.5 million, net cash used in financing activities was approximately \$1.2 million and net cash used in investing activities was approximately \$326,000 resulting in an increase in cash and cash equivalents for the first six months of 2002 of approximately \$1.0 million. Capital expended during the period included approximately \$310,000 for the purchase of operating equipment.

We estimate aggregate capital expenditures, exclusive of acquisitions of businesses, of approximately \$300,000 for the remainder of the year ending December 31, 2002.

At June 30, 2002, we had borrowings of approximately \$33.8 million. We had two letters of credit outstanding at June 30, 2002, totaling \$304,000 as collateral relating to worker compensation insurance policies. We do not have a revolving credit facility. 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

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

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.

The Company is obligated under various operating leases, primarily for certain equipment, vehicles, and real estate. 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 December 31, 2001 are as follows: 2002 - \$1,408,483; 2003 - \$1,311,477; 2004 - \$1,281,728; 2005 - \$1,067,305; 2006 - \$702,083; and 2007 and thereafter - \$3,038,389.

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 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.

### Seasonality and Inflation

The Company believes that its car washing and detailing operations are adversely affected by periods of inclement weather. The Company has mitigated, and intends to continue to mitigate, the impact of inclement weather through geographic diversification of its operations.

18

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 Six Months Ended June 30, 2002  
Compared to the Six Months Ended June 30, 2001

Revenues

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

### Car Care Services

Revenues for the six months ended June 30, 2002 were \$23.1 million as compared to \$25.7 million for the six months ended June 30, 2001, a decrease of \$2.6 million or 10.2%. Of the \$2.6 million decrease, approximately \$1.8 million was from wash and detail services, \$319,000 was from lube and other automotive services, \$446,000 was from fuel and merchandise sales. Of the \$23.1 million of revenues for the six months ended June 30, 2002, \$19.5 million or 84% was generated from car wash and detailing, \$2.0 million or 9% from lube and other automotive services, and \$1.6 million or 7% from fuel and merchandise sales. Of the \$25.7 million of revenues for the six months ended June 30, 2001, \$21.4 million or 83% was generated from car wash and detailing, \$2.3 million or 9% from lube and other automotive services, and \$2.0 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 current quarter ended June 30, 2002. These declines in volume were partially offset by increased prices through a continued aggressive focus on selling detailing and additional on-line car wash services which increased the average wash and detailing revenues per car to \$13.83 in 2002, from \$13.65 per car in the first half of 2001. As to the decline in lube and other automotive services, we discontinued the practice of providing a free wash to lube customers resulting in decreased lube revenues but improved overall site gross margin performance. The decline in fuel and merchandise gross revenues is the result of instituting certain minimum sale margin criteria which reduced gross 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 two months in which the Company operated this division, May and June of 2002, were \$397,000.

### Cost of Revenues

#### Car Care Services

Cost of revenues for the six months ended June 30, 2002 were \$16.0 million or 69% of revenues with car washing and detailing costs at 67% of respective revenues, lube and other automotive services costs at 79% of respective revenues, and fuel and merchandise costs at 86% of respective revenues. Cost of revenues for the six months ended June 30, 2001 were \$18.2 million, or 71% of revenues. With our increase 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 labor costs as a percent of car wash and detail revenues to 45.7% in 2002 as compared to 46.9% in the first six months of 2001.

#### Security Products

During 2001 and for the first four months of 2002, pursuant to a Management Agreement, no costs were incurred by us. During May and June of 2002, cost of revenues were \$225,000 or 57% of revenues.

### Selling, General and Administrative Expenses



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

Selling, general and administrative expenses for the six months ended June 30, 2002 were \$3.83 million compared to \$3.76 million for the same period in 2001, an increase of approximately \$78,000 or 2%. SG&A costs as a percent of revenues were 16.2% for the six months ended June 30, 2002 as compared to 14.5% in the first half 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 \$206,000 of SG&A

19

costs in 2002 combined with an increase in advertising and insurance costs. This increase was partially offset by a decrease in administrative salaries and certain office costs.

### Depreciation and Amortization

Depreciation and amortization totaled \$982,000 for the six months ended June 30, 2002 as compared to \$1.35 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.

### Interest Expense, Net

Interest expense, net of interest income, for the six months ended June 30, 2002, was \$1.1 million compared to \$1.6 million for the six months ended June 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 and Expense

Other income for the six months ended June 30, 2002 was \$147,000 compared to \$139,000 for the six months ended June 30, 2001.

### Income Taxes

We recorded a tax expense of \$589,000 for the six months ended June 30, 2002. Tax expense reflects the recording of income taxes 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 June 30, 2002  
Compared to the Three Months Ended June 30, 2001

### Revenues

#### Car Care Services

Revenues for the three months ended June 30, 2002 were \$11.4 million as compared to \$13.0 million for the three months ended June 30, 2001, a decrease of \$1.6 million or 12%. Of the \$1.6 million decrease, approximately \$1.2 million was from wash and detail services, \$149,000 was from lube and other automotive services, \$192,000 was from fuel and merchandise sales. Of the \$11.4 million of revenues for the three months ended June 30, 2002, \$9.6 million or 83% was generated from car wash and detailing, \$1.0 million or 9% from lube and other

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

automotive services, and \$873,000 or 8% from fuel and merchandise sales. Of the \$13.0 million of revenues for the three months ended June 30, 2001, \$10.8 million or 83% was generated from car wash and detailing, \$1.1 million or 9% from lube and other automotive services, and \$1.1 million or 8% from fuel and merchandise sales. The decrease in wash and detailing revenues was principally due to the divesting of one of our car wash locations since the second quarter of 2001, as well as a reduction in the level of pollen in our East region, and more challenging weather within the Company's Texas region principally within the Dallas/Ft. Worth market. As to the decline in lube and other automotive services, we discontinued the practice of providing a free wash to lube customers resulting in decreased lube revenues but improved overall site gross margin performance. The decline in fuel and merchandise gross revenues is the result of instituting certain minimum sale margin criteria which reduced gross 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 two months in which the Company operated this division, May and June of 2002, were \$397,000.

20

## Cost of Revenues

### Car Care Services

Cost of revenues for the three months ended June 30, 2002 were \$8.0 million or 70% of revenues with car washing and detailing costs at 67% of respective revenues, lube and other automotive services costs at 83% of respective revenues, and fuel and merchandise costs at 86% of respective revenues. Cost of revenues for the three months ended June 30, 2001 were \$9.1 million, or 70% of revenues. With 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 car direct labor costs as a percent of car wash and detail revenues to 46.6% in 2002 as compared to 47.6% in the second quarter of 2001.

### Security Products

During 2001 and for the first four months of 2002, pursuant to a Management Agreement, no costs were incurred by us. During May and June of 2002, cost of revenues were \$225,000 or 57% of revenues.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for the three months ended June 30, 2002 were \$2.0 million compared to \$1.9 million for the same period in 2001, an increase of approximately \$123,000 or 6%. SG&A costs as a percent of revenues were 17.2% for the three months ended June 30, 2002 as compared to 14.7% in the second 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 \$206,000 of SG&A costs in 2002 combined with an increase in advertising and insurance costs. This increase was partially offset by a decrease in administrative salaries and certain office costs.

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

### Depreciation and Amortization

Depreciation and amortization totaled \$510,000 for the three months ended June 30, 2002 as compared to \$678,000 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.

### Interest Expense, Net

Interest expense, net of interest income, for the three months ended June 30, 2002, was \$553,000 compared to \$733,000 for the three months ended June 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 and Expense

Other income for the three months ended June 30, 2002 was \$82,000 compared to \$77,000 for the three months ended June 30, 2001.

### Income Taxes

We recorded a tax expense of \$201,000 for the three months ended June 30, 2002. Tax expense reflects the recording of income taxes 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 outside the car care industry. To the extent we make acquisitions inside or outside the

21

car care industry, 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, 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

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

- 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. If our common stock does not maintain a minimum bid price of one dollar for thirty consecutive days, we are subject to being delisted from the Nasdaq National Market. 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. Upon delisting 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. Upon delisting 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."

Our bid price has been below one dollar since July 10, 2002. Unless the bid price of our common stock closes above one dollar for at least one day before August 20, 2002, we may be subject to delisting as described above.

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 subsequent quarters 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 financing acquisitions and business growth, we anticipate that we will continue to incur 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

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

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 our car and truck wash businesses. Since July 1999, our main business has been the acquisition and operation of car wash facilities, which now accounts for substantially all of our revenues.

22

Because of our relatively limited operating history with respect to this business, we cannot assure you that we will be able to operate it successfully.

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 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 and achieve operating efficiencies. If we acquire new businesses, we may not be able to successfully operate and integrate the acquired businesses. 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,

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

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.

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 properly maintain the equipment, the car wash could become inoperable 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 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. 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

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

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 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

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

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.

24

## PART II

### OTHER INFORMATION

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

#### (a) Exhibits:

- 10.139 Term note dated April 30, 2002, between the Company, its subsidiary, One, Texas, N.A. in the amount of \$342,000.
- 10.140 Master Lease Agreement dated June 10, 2002, between the Company, its Car Wash, Inc., and Banc One Leasing Corporation in the amount of \$193
- 10.141 Amendment dated July 22, 2002 to Management Agreement between the Comp
- 10.142 Amendment dated July 22, 2002 to Lease Agreement between the Company a

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

On May 31, 2002, the Company filed a report on Form 8-K dated May 31, 2002, under Item 5 to report a change in the date of the Annual Stockholders Meeting and deadlines for submission of shareholder proposals.

25

### 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.

-----



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

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: August 14, 2002

26

EXHIBIT INDEX

Exhibit No.	Description
10.139	Term note dated April 30, 2002, between the Company, its subsidiary, Mace T and Bank One, Texas, N.A. in the amount of \$342,000.
10.140	Master Lease Agreement dated June 10, 2002, between the Company, its subsid Full Service Car Wash, Inc., and Banc One Leasing Corporation in the amount
10.141	Amendment dated July 22, 2002 to Management Agreement between the Company a Inc.
10.142	Amendment dated July 22, 2002 to Lease Agreement between the Company and Ve Properties, Inc.