

MACE SECURITY INTERNATIONAL INC
Form 10-Q
May 10, 2005

=====

UNITED STATES
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 MARCH 31, 2005 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 ("the Exchange Act") 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 No

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

As of May 6, 2005 there were 15,271,132 Shares of Registrant's Common Stock, par value \$.01 per share, outstanding.

=====

MACE SECURITY INTERNATIONAL, INC.
FORM 10-Q
QUARTER ENDED MARCH 31, 2005

CONTENTS

PART I - FINANCIAL INFORMATION

Item 1 - Financial Statements

PAGE

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

Consolidated Balance Sheets - March 31, 2005 (Unaudited) and December 31, 2004	2
Consolidated Statements of Income (Unaudited) for the three months ended March 31, 2005 and 2004	4
Consolidated Statement of Stockholders' Equity for the three months ended March 31, 2005 (Unaudited)	5
Consolidated Statements of Cash Flows (Unaudited) for the three months ended March 31, 2005 and 2004	6
Notes to Consolidated Financial Statements (Unaudited)	7
Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3 - Quantitative and Qualitative Disclosures about Market Risk	29
Item 4 - Controls and Procedures	30
 PART II - OTHER INFORMATION	
Item 1 - Legal Proceedings	30
Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds	30
Item 6 - Exhibits	31
Signatures	32

1

PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MACE SECURITY INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In thousands, except share information)

	MARCH 31, 2005	DECEMBER 2004
ASSETS	-----	-----
	(Unaudited)	
Current assets:		
Cash and cash equivalents	\$ 12,962	\$ 14,000
Accounts receivable, less allowance for doubtful accounts of \$520 and \$449 in 2005 and 2004, respectively	2,472	2,472
Inventories	7,904	7,904
Deferred income taxes	321	321
Prepaid expenses and other current assets	1,907	1,907
Asset held for sale	243	243
	-----	-----

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

Total current assets	25,809	27
Property and equipment:		
Land	31,639	31
Buildings and leasehold improvements	36,537	36
Machinery and equipment	11,707	11
Furniture and fixtures	536	
	-----	-----
Total property and equipment	80,419	79
Accumulated depreciation and amortization	(13,550)	(13)
	-----	-----
Total property and equipment, net	66,869	66
Goodwill	3,587	3
Other intangible assets, net of accumulated amortization of \$346 and \$309 in 2005 and 2004, respectively	2,893	2
Deferred income taxes	1,992	2
Other assets	256	
	-----	-----
TOTAL ASSETS	\$ 101,406	\$ 102
	=====	=====

See accompanying notes.

2

	MARCH 31, 2005	DECEMBER 31, 2004
	-----	-----
LIABILITIES AND STOCKHOLDERS' EQUITY		
(Unaudited)		
Current liabilities:		
Current portion of long-term debt and capital lease obligations	\$ 2,555	\$
Accounts payable	3,231	
Income taxes payable	283	
Deferred revenue	439	
Accrued expenses and other current liabilities	2,662	
	-----	-----
Total current liabilities	9,170	
Long-term debt, net of current portion	25,658	
Capital lease obligations, net of current portion	69	
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 15,271,132 in both 2005 and 2004	153	
Additional paid-in capital	88,456	
Accumulated other comprehensive loss	(3)	
Accumulated deficit	(22,097)	
	-----	-----
Total stockholders' equity	66,509	

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

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

\$ 101,406
=====

\$
=====

See accompanying notes.

3

MACE SECURITY INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(In thousands, except share information)

	THREE MONTHS ENDED MARCH 31,	
	2005	2004
	-----	-----
Revenues:		
Car wash and detailing services	\$ 8,712	\$ 8,910
Lube and other automotive services	791	930
Fuel and merchandise sales	983	959
Security sales	6,365	1,876
	-----	-----
	16,851	12,675
Cost of revenues:		
Car wash and detailing services	6,189	6,287
Lube and other automotive services	654	705
Fuel and merchandise sales	852	826
Security sales	4,579	1,180
	-----	-----
	12,274	8,998
Selling, general and administrative expenses	3,608	2,471
Depreciation and amortization	590	500
	-----	-----
Operating income	379	706
Interest expense, net	(451)	(479)
Other income	89	112
	-----	-----
Income before income taxes	17	339
Income tax expense	6	122
	-----	-----
Net income	\$ 11	\$ 217
	=====	=====
Per share of common stock (basic and diluted):		
Net income	\$ 0.00	\$ 0.02
	=====	=====
Weighted average shares outstanding:		
Basic	15,271,132	12,461,029

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

Diluted 15,655,863 12,618,837

See accompanying notes.

4

MACE SECURITY INTERNATIONAL, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
 (UNAUDITED)

(In thousands, except share information)

	COMMON SHARES	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED OTHER COMPREHENSIVE LOSS
	-----	-----	-----	-----
BALANCE AT DECEMBER 31, 2004	15,271,132	\$ 153	\$ 88,507	\$
Costs associated with private placement.....			(51)	
Change in fair value of cash flow hedge.....				
Net income.....				
Total comprehensive income.....				
BALANCE AT MARCH 31, 2005.....	15,271,132	\$ 153	\$ 88,456	\$
	=====	=====	=====	=====

See accompanying notes.

5

MACE SECURITY INTERNATIONAL, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF CASH FLOWS
 (UNAUDITED)

(In thousands)

	THREE MONTHS ENDED MARCH 31,	
	2005	2004
	-----	-----
OPERATING ACTIVITIES		
Net income	\$ 11	\$ 217
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	590	500
Provision for losses on receivables	71	32
Gain on sale of property and equipment	(33)	-
Deferred income taxes	16	112
Changes in operating assets and liabilities:		

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

Accounts receivable	14	(56)
Inventories	(837)	484
Accounts payable	(846)	(603)
Deferred revenue	(30)	(56)
Accrued expenses	295	529
Income taxes	5	77
Prepaid expenses and other assets	178	(195)
	-----	-----
Net cash (used in) provided by operating activities	(566)	1,041
 INVESTING ACTIVITIES		
Purchase of property and equipment	(396)	(141)
Proceeds from sale of property and equipment	390	-
Payments for intangibles	(1)	(29)
	-----	-----
Net cash used in investing activities	(7)	(170)
 FINANCING ACTIVITIES		
Payments on long-term debt and capital lease obligations	(913)	(660)
(Costs) proceeds from issuance of common stock	(51)	26
	-----	-----
Net cash used in financing activities	(964)	(634)
	-----	-----
Net (decrease) increase in cash and cash equivalents	(1,537)	237
Cash and cash equivalents at beginning of period	14,499	3,414
	-----	-----
Cash and cash equivalents at end of period	\$ 12,962	\$ 3,651
	=====	=====

See accompanying notes.

6

MACE SECURITY INTERNATIONAL, INC. AND SUBSIDIARIES 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", "we" or "Mace"). All significant intercompany transactions have been eliminated in consolidation. These consolidated interim 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 month period ended March 31, 2005 are not necessarily indicative of the operating results for the full year. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. These consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and notes contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

2. NEW ACCOUNTING STANDARDS

In November 2004, the Financial Accounting Standards Board ("FASB") issued

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

Statement of Financial Accounting Standards ("SFAS") 151, Inventory Costs- An Amendment of ARB No. 43, Chapter 4. SFAS 151 amends the guidance in ARB 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS 151 is effective for fiscal years beginning after June 15, 2005 and is required to be adopted by the Company in the first quarter of fiscal 2006. The Company does not expect SFAS 151 to have a material impact on the Company.

In December 2004, the FASB issued SFAS 153, Exchange of Nonmonetary Assets - An Amendment of APB Opinion No. 18. Accounting for Nonmonetary Transactions. SFAS 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of Accounting Principles Board ("APB") Opinion 29, and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 is effective for fiscal periods beginning after June 15, 2005. The Company does not expect SFAS 153 to have a material impact on the Company.

In December 2004, the FASB issued SFAS 123(R), Share-Based Payment. SFAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. The cost will be measured based on the fair value of the equity or liability instruments issued. SFAS 123(R) is effective as of the first interim or annual reporting period of the first fiscal year beginning on or after June 15, 2005. SFAS 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. In addition to the accounting standard that sets forth the financial reporting objectives and related accounting principles, SFAS 123(R) includes an appendix of implementation guidance that provides expanded guidance on measuring the fair value of share-based payment awards. SFAS 123(R) replaces SFAS 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion 25, Accounting for Stock Issued to Employees. SFAS 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that Statement permitted entities the option of continuing to apply the guidance in APB Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Additionally, in March 2005, the SEC issued Staff Accounting Bulletin ("SAB") 107, Share-Based Payments, which provides further guidance for the adoption of SFAS 123(R), discussed above. The Company will implement this new standard in the first quarter of our fiscal year 2006. The Company is currently evaluating this statement and the effects on our results of operations. The Company believes that implementation of SFAS 123 (R) will have a material impact on the Company.

7

3. OTHER INTANGIBLE ASSETS

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

MARCH 31, 2005		DECEMBER 31, 2004	
GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION

Amortized intangible assets:

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

Non-compete agreement	\$ 28	\$ 15	\$ 28	\$
Customer lists	699	101	699	
Product lists	590	44	590	
Deferred financing costs	415	186	421	
	-----	-----	-----	-----
Total amortized intangible assets	1,732	346	1,738	
Non-amortized intangible assets:				
Trademarks - Security Segment	1,401	-	1,400	
Service mark - Car and Truck Wash Segment	106	-	106	
	-----	-----	-----	-----
Total non-amortized intangible assets	1,507	-	1,506	
	-----	-----	-----	-----
Total intangible assets	\$ 3,239	\$ 346	\$ 3,244	\$
	=====	=====	=====	=====

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

2005	\$	168
2006	\$	153
2007	\$	149
2008	\$	143
2009	\$	143

4. BUSINESS COMBINATIONS

On July 1, 2004, the Company, through its wholly owned subsidiary, Mace Security Products, Inc., acquired substantially all of the operating assets of Industrial Vision Source(R) ("IVS") and SecurityandMore(R) ("S&M") from American Building Control, Inc. The results of operations of IVS and S&M have been included in the consolidated financial statements of the Company since July 1, 2004. S&M supplies video surveillance and security equipment, and IVS is a distributor of technologically advanced imaging components and video equipment. The acquisition of IVS and S&M furthers the Company's expansion of our Security Segment. The acquisition also expands our presence in the southwestern part of the United States and provides us with new mass merchant opportunities, an active e-commerce web site, a catalog sales channel and a high-end digital and fiber optics camera product line. The purchase price for IVS and S&M consisted of approximately \$5.62 million of cash and the assumption of \$290,000 of current liabilities. The purchase price was allocated as follows: approximately \$1.86 million for inventory; \$1.37 million for accounts receivable; \$100,000 for equipment; and the remainder of \$2.58 million allocated to goodwill and other intangible assets. Of the \$2.58 million of acquired intangible assets, \$830,000 was assigned to registered trademarks and \$531,000 was assigned to goodwill, neither of which is subject to amortization expense. The remaining intangible assets were assigned to customer lists for \$630,000 and product lists for \$590,000. Customer and product lists were assigned a useful life of 10 years. The acquisition was accounted for as a business combination in accordance with SFAS 141, Business Combinations.

The pro forma financial information presented below gives effect to the IVS and S&M acquisition as if it had occurred as of the beginning of our fiscal year 2004. The information presented below is for illustrative purposes only and is not necessarily indicative of results that would have been achieved if the acquisition actually had occurred as of the beginning of 2004 or results which may be achieved in the future. Unaudited pro forma financial information is as follows (in thousands, except per shares amounts):

	THREE MONTHS ENDED MARCH 31,	
	2005	2004
Revenues	\$ 16,851	\$ 17,766
Net income	\$ 11	\$ 247
Income per share-basic and dilutive	\$ 0.00	\$ 0.02

5. STOCK-BASED COMPENSATION

The Company has two stock-based employee compensation plans. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board Opinion ("APB") No. 25, Accounting for Stock Issued to Employees, and related interpretations. Stock-based employee compensation costs are not reflected in net income, as all options granted under the plan had exercise prices equal to the market value of the underlying common stock on the date of grant. The table below illustrates the effect on net (loss) income and (loss) income per share if the Company had applied the fair value recognition provisions of FASB 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

The Company has elected to follow APB 25, and related Interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under SFAS 123, requires use of option valuation models that are not developed for use in valuing employee stock options. Under APB 25, if the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. In December 2004, the FASB issued Statement 123(R) Share-Based Payment. SFAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. This statement will be effective as of the first quarter of 2006.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. Pro forma results are not likely to be representative of the effects on reported or pro forma results of operations for future years. The Company's pro forma information is as follows (in thousands, except per share data):

	THREE MONTHS ENDED MARCH 31,	
	2005	2004
Net income, as reported	\$ 11	\$ 217
Less: Stock-based compensation costs under fair		

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

value based method for all awards	(219)	(88)
	-----	-----
Pro forma net (loss) income	\$ (208)	\$ 129
	=====	=====
Earnings per share - basic and diluted		
As reported	\$ 0.00	\$ 0.02
Pro forma	\$ (0.01)	\$ 0.01

The fair value of each option grant is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted average assumptions for grants in the quarter ended March 31, 2004: 170,000 options granted; expected volatility of 20%; risk-free interest rates ranging from 3.80% to 4.05%; and expected life of 10 years. In the quarter ended March 31, 2005, 90,000 options were granted with an expected volatility of 56%, risk-free interest rate of 4.06% and expected life of 10 years.

9

6. COMMITMENTS AND CONTINGENCIES

In December 2003, one of the Company's car wash subsidiaries was named as a defendant in a suit filed by Kristen Sellers in the Circuit Court of the Twelfth Judicial Circuit in and for Sarasota County, Florida. The suit alleges that the plaintiff is entitled to damages in excess of \$15,000 due to psychological injury and emotional distress sustained when an employee of the car wash allegedly assaulted Ms. Sellers with sexually explicit acts and words. The Company's subsidiary is alleged to have been negligent in hiring, retaining and supervising the employee. The Company forwarded the suit to its insurance carrier for defense. The plaintiff has communicated that the case could be settled for \$95,000.

The Company has produced documents requested in a subpoena issued in connection with an investigation conducted by the United States Securities and Exchange Commission of possible securities law violations. The subpoena was issued on October 27, 2003. The Company produced all documents that were requested and has not been contacted by the United States Securities and Exchange Commission regarding the investigation since February, 2004. The Company intends to fully cooperate with the United States Securities and Exchange Commission's investigation.

On July 20, 2004, the Company received a letter from the United States Securities and Exchange Commission. This letter requested that the Company voluntarily provide information and documents relating to Price Legacy Corporation's sale of 1,875,000 shares of the Company's common stock on the open market in April, 2004 and Price Legacy Corporation's payment of \$8.95 million to the Company in exchange for the Company removing a sales restriction from 1,750,000 of the shares that were sold. The Company supplied the information in August of 2004. The Company has not been contacted by the Securities and Exchange Commission since supplying the information. The Company intends to fully cooperate with the United States Securities and Exchange Commission in this matter.

Certain of the Company's executive officers have entered into employee stock option agreements whereby options issued to them shall be entitled to immediate vesting 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 \$2.5 million upon termination of employment under certain conditions. The employment agreement also provides for a bonus of \$2.5 million upon a change in control.

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

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 is 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.

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, in all material respects, with all applicable laws relating to its business.

10

7. BUSINESS SEGMENTS INFORMATION

The Company currently operates in two segments: the Car and Truck Wash Segment, supplying complete car care services (including wash, detailing, lube, and minor repairs), fuel, and merchandise sales; and the Security Segment.

Financial information regarding the Company's segments is as follows (in thousands):

	CAR AND TRUCK WASH -----	SECURITY -----	CORPORATE FUNCTIONS * -----
THREE MONTHS ENDED MARCH 31, 2005			
Revenues from external customers	\$ 10,486	\$ 6,365	\$ -
Intersegment revenues	\$ -	\$ 140	\$ -
Segment operating income (loss)	\$ 1,247	\$ (1)	\$ (867)
Segment assets	\$ 82,165	\$ 19,241	\$ -
Goodwill	\$ 2,655	\$ 932	\$ -
Capital expenditures	\$ 276	\$ 118	\$ 2
THREE MONTHS ENDED MARCH 31, 2004			
Revenues from external customers	\$ 10,799	\$ 1,876	\$ -
Intersegment revenues	\$ -	\$ 3	\$ -
Segment operating income (loss)	\$ 1,456	\$ (1)	\$ (749)
Segment assets	\$ 82,841	\$ 7,290	\$ -
Goodwill	\$ 10,381	\$ 242	\$ -
Capital expenditures	\$ 136	\$ 5	\$ -

* 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.

8. USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles

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

generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the disclosure of contingent assets and liabilities at the date of its financial statements. The Company bases its estimates on historical experience, actuarial valuations and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Some of those judgments can be subjective and complex, and consequently, actual results may differ from these estimates under different assumptions or conditions. We must make these estimates and assumptions because certain information that we use is dependent on future events and cannot be calculated with a high degree of precision from the data currently available. 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, Goodwill and Other Intangible Assets.

9. INCOME TAXES

The Company recorded income tax expense of \$6,000 and \$122,000 for the three months ended March 31, 2005 and 2004, respectively. Income tax expense reflects the recording of income taxes on income at an effective rate of approximately 36% in both 2005 and 2004. The effective rate differs from the federal statutory rate for each year primarily due to state and local income taxes, non-deductible costs related to intangibles, fixed asset adjustments and changes to the valuation allowance.

10. RELATED PARTY TRANSACTIONS

From November, 2001 through July 2002, the Company prepaid LP Learjets, LLC \$5,109 per month for the right to use a Learjet 31A for 100 hours per year. LP Learjets, LLC is a company owned by Louis D. Paolino, Jr., the Company's Chairman, Chief Executive Officer and President. When the Learjet 31A is used, the prepaid amount is reduced by the hourly usage charge as approved by the Audit Committee, and 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. The balance of unused prepaid flight fees totaled \$31,659 at March 31, 2005 and December 31, 2004.

11

From January 1, 2004 through March 31, 2005, Louis D. Paolino, Jr. purchased approximately \$26,000 of the Company's products at a discount from the prices charged to distributors. The total of the discount given to Mr. Paolino was approximately \$8,500.

The Company's Security Segment leases manufacturing and office space under a five-year lease with Vermont Mill, Inc. ("Vermont Mill"), which provided for monthly lease payments of \$9,167 through November 2004. Vermont Mill is controlled by Jon E. Goodrich, a former director and current employee of the Company. The Company has exercised an option to continue the lease through November 2009 at a rate of \$10,576 per month. The Company believes that the lease rate is lower than lease rates charged for similar properties in the Bennington, Vermont area. On July 22, 2002, the lease was 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.

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

From January 1, 2004 through March 31, 2005, the Company's Security Segment sold approximately \$124,000 of electronic security equipment to two companies, each of which Louis Paolino, III, the son of the Company's CEO, Louis D. Paolino, Jr., is a partial owner. The pricing extended to these companies is no more favorable than the pricing given to third party customers who purchase in similar volume. At March 31, 2005, \$6,828 was owed from one of these companies to Mace.

Louis Paolino III, the son of the Company's Chief Executive Officer, Louis Paolino, Jr., has offered to purchase from the Company a warehouse bay in Hollywood, Florida that is no longer used in the Company's operations for \$306,000 in cash. The Company paid \$256,688 for the property in 2003. The warehouse property was appraised by a third party independent appraiser on January 18, 2005 at an estimated market value of \$306,000. On February 14, 2005, the Company's Audit Committee authorized the Company to proceed with a sale of the warehouse property to Louis Paolino III for \$306,000. A sale has not been consummated and the related assets remain classified as held for sale at March 31, 2005.

11. EQUITY

On April 16, 2004, the Company received approximately \$8.95 million in cash from Price Legacy Corporation (formerly Excel Legacy Holdings, Inc.) in exchange for the Company removing a contractual restriction that prohibited Price Legacy Corporation from selling 1,750,000 shares of the Company's common stock without the Company's approval. The Company recorded this transaction as a contribution to capital, net of related income taxes, in accordance with APB Opinion No. 9. The proceeds will be used as part of working capital. Price Legacy Corporation purchased 125,000 restricted shares in July of 1999 and received 1,750,000 shares in October of 1999 in a transaction in which the Company purchased the car wash assets of Millennia Car Wash, LLC. Additionally, as part of the agreement, the Company agreed to indemnify Price Legacy Corporation against certain potential circumstances as a result of lifting the restriction. Management believes the fair value of this provision is negligible.

On April 20, 2004, the Company purchased a 20,000 square foot facility in Fort Lauderdale, Florida, to serve as its regional headquarters for its electronic surveillance products operation. Consideration for the facility consisted of 250,000 registered shares of the Company's common stock valued at approximately \$1.6 million.

The Master Facility Agreement between the Company and Fusion Capital Fund II, LLC ("Fusion") and the Equity Purchase Agreement between the Company and Fusion was terminated. Under the Master Facility Agreement, the Company had entered into an Equity Purchase Agreement on April 17, 2000. Under the Equity Purchase Agreement, Fusion had the right and obligation to purchase up to \$10 million of the Company's common stock under certain conditions. On April 21, 2004, the Company and Fusion entered into a termination and release agreement under which the Company sold Fusion 150,000 registered shares of the Company's common stock at \$2.32 per share and terminated the Equity Purchase Agreement.

On May 26, 2004, the Company sold 915,000 shares of the Company's common stock and issued a warrant for 183,000 shares of the Company's common stock in exchange for \$5,005,050 in cash. The purchaser was Langley Partners, L.P., an accredited investor. The warrant is exercisable by Langley Partners, L.P. at any time up to May 26, 2009 at a price of \$7.50 per share. The securities sold were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933 and Regulation D promulgated under the Securities Exchange Act of 1934. The securities were registered for resale by Langley Partners, L.P. effective September 28, 2004 on a Form S-3 Registration Statement.

On December 14, 2004, the Company sold 750,000 shares of the Company's common

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

stock and issued a warrant for 150,000 shares of the Company's common stock in exchange for \$3,307,500 in cash. The purchaser was Langley Partners, L.P., an accredited investor. The warrant is exercisable by Langley Partners, L.P. at any time up to December 14, 2009 at a price of \$5.88 per share. The securities sold were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933 and Regulation D promulgated under the Securities Act of 1934. The securities were registered for resale by Langley Partners, L.P. effective February 3, 2005 on a Form S-3 Registration Statement.

12

On December 14, 2004, the Company sold 400,000 shares of the Company's common stock and issued a warrant for 50,000 shares of the Company's common stock in exchange for \$1,872,000 in cash. The purchaser was JMB Capital Partners, L.P., an accredited investor. The warrant is exercisable by JMB Capital Partners, L.P. at any time up to December 14, 2009, at a price of \$5.88 per share. The securities sold were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933 and Regulation D promulgated under the Securities Act of 1934. The securities were registered for resale by JMB Capital Partners, L.P. effective February 3, 2005 on a Form S-3 Registration Statement.

On July 29, 2004, the Company's Board of Directors authorized a Stock Buy Back Plan to purchase shares of the Company's common stock up to a maximum value of \$3.0 million. Purchases will be made in the open market if and when management decides to effect purchases. Management may elect not to make purchases or to make purchases less than \$3.0 million in amount. As of May 6, 2005, the Company did not purchase any shares on the open market.

12. LONG-TERM DEBT, NOTES PAYABLE AND CAPITAL LEASE OBLIGATIONS

At March 31, 2005, we had borrowings, including capital lease obligations, of approximately \$28.3 million, substantially all of which is secured by mortgages against certain of our real property. Of such borrowings, approximately \$2.6 million is classified as current as it is due in less than 12 months from March 31, 2005. We had letters of credit outstanding at March 31, 2005, totaling \$1.1 million as collateral relating to workers' compensation insurance policies. We maintain a \$500,000 revolving credit facility, subject to an availability calculation based on inventory and accounts receivable, to provide financing for additional electronic surveillance product inventory purchases. There were no borrowings outstanding under the revolving credit facility at March 31, 2005.

Our two most significant borrowings are secured notes payable to General Motors Acceptance Corp. ("GMAC") in the amount of \$10.4 million, \$9.5 million of which was classified as non-current debt at March 31, 2005, and secured notes payable to Bank One, Texas, N.A. ("Bank One") in the amount of \$14.2 million, \$12.8 million of which was classified as non-current debt at March 31, 2005. The GMAC and Bank One agreements contain affirmative and negative covenants, including the maintenance of certain levels of tangible net worth, maintenance of certain levels of unencumbered cash and marketable securities, limitations on capital spending and the maintenance of certain debt coverage ratios on a consolidated level. The Bank One agreement is our only debt agreement that contains an express prohibition on incurring additional debt for borrowed money without the approval of the lender. None of our other agreements contain such a prohibition. Twenty five car washes, one truck wash and our warehouse and office facility in Farmers Branch, Texas are encumbered by mortgages.

At March 31, 2005, we were not in compliance with our semi-annual consolidated debt coverage ratio of at least 1.25:1 related to our GMAC notes payable. The Company's debt coverage ratio related to the GMAC notes payable was .89:1 at March 31, 2005. GMAC granted us a waiver of acceleration related to the non-compliance with the debt coverage ratio covenant at March 31, 2005, and for

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

measurement periods through April 1, 2006 and, accordingly, a portion of the GMAC notes payable was reflected as non-current on our financial statements at March 31, 2005. If we are not able to achieve a debt coverage ratio of at least 1.25:1, or we cannot obtain further waivers of acceleration, the GMAC notes may be reflected as current in future balance sheets and as a result our stock price may decline.

The Company entered into amendments to the Bank One term loan agreements effective March 31, 2004. The amended debt coverage ratio with Bank One requires the Company to maintain a ratio of consolidated earnings before interest, income taxes, depreciation and amortization to debt service of 1.05:1 at December 31, 2004 and thereafter. The Company's debt coverage ratio was .86:1 at March 31, 2005, which was not in compliance with this Bank One covenant as amended. The Company received a waiver of acceleration with respect to this debt coverage ratio from Bank One through April 1, 2006 and, accordingly, a portion of the Bank One notes payable was reflected as non-current on our financial statements at March 31, 2005. The Bank One amendment also requires the maintenance of a minimum total unencumbered cash and marketable securities balance of \$5.0 million. This cash balance requirement will be lowered to \$1 million upon the Company returning to a debt coverage ratio of at least 1.10 :1. If we are unable to satisfy these covenants or obtain further waivers, the Bank One notes may be reflected as current in future balance sheets and as a result our stock price may decline.

Our ongoing ability to comply with the debt covenants under our credit arrangements and refinance our debt depends largely on our achievement of adequate levels of cash flow. Our cash flow has been and could continue to be adversely affected by weather patterns and economic conditions. In the future, if our cash flows are less than expected or debt service, including interest expense, increases more than expected, we may continue to be out of compliance with the Bank One and GMAC covenants and may need to seek additional waivers or amendments.

13

If we default on any of the Bank One or GMAC covenants and are not able to obtain further amendments or waivers of acceleration, Bank One debt totaling \$14.2 million and GMAC debt totaling \$10.4 million, including debt recorded as long-term debt at March 31, 2005, could become due and payable on demand, and Bank One and/or GMAC could foreclose on the assets pledged in support of the relevant indebtedness. If our assets (including up to 25 of our car wash facilities and one truck wash facility) are foreclosed upon, revenues from our Car and Truck Wash Segment, which comprised 71% of our total revenues for fiscal year 2004 and 62% of our total revenues in the first quarter of 2005, would be severely impacted and we could be unable to continue to operate our business. Even if the debt were accelerated without foreclosure, it would be very difficult for us to continue to operate our business and we may go out of business.

13. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

THREE MONTHS ENDED MARCH 31,	
2005	2004
-----	-----

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

Numerator:

Net income	\$ 11	\$ 217
	=====	=====

Denominator:

Denominator for basic income per share - weighted average shares.....	15,271,132	12,461,029
Dilutive effect of options and warrants.....	384,731	157,808
	-----	-----
Denominator for diluted income per share - weighted average shares.....	15,655,863	12,618,837
	=====	=====

Basic and diluted income per share:

Net income.....	\$ 0.00	\$ 0.02
	=====	=====

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 report 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 important 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 important 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

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

The discussion and analysis of our financial condition and results of operations is 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 amounts of assets and liabilities, revenues and expenses, and related disclosures 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's critical accounting policies are described below.

REVENUE RECOGNITION

Revenues from the Company's Car and Truck Wash Segment are recognized, net of customer coupon discounts, when services are rendered or fuel or merchandise is sold. The Company records a liability for gift certificates, ticket books, and seasonal and annual passes sold at its car care locations but not yet redeemed. The Company estimates these unredeemed amounts based on gift certificate and ticket book sales and redemptions throughout the year as well as utilizing historical sales and tracking of redemption rates per the car washes' point-of-sale systems. Seasonal and annual passes are amortized on a straight-line basis over the time during which the passes are valid.

Revenues from the Company's Security Segment are recognized when shipments are made, or for export sales when title has passed. Shipping and handling charges billed are included in revenues; the cost of which is included in SG&A expenses.

IMPAIRMENT OF LONG-LIVED ASSETS

In accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we periodically review the carrying value of our long-lived assets held and used, and assets to be disposed of, when events and circumstances warrant such a review. If significant events or changes in circumstances indicate that the carrying value of an asset or asset group may not be recoverable, we perform a test of recoverability by comparing the carrying value of the asset or asset group to its undiscounted expected future cash flows. Cash flow projections are sometimes based on a group of assets, rather than a single asset. If cash flows cannot be separately and independently identified for a single asset, we determine whether an impairment has occurred for the group of assets for which we can identify the projected cash flows. If the carrying values are in excess of undiscounted expected future cash flows, we measure any impairment by comparing the fair value of the asset group to its carrying value. If the fair value of an asset or asset group is determined to be less than the carrying amount of the asset or asset group, an impairment in the amount of the difference is recorded.

GOODWILL

In accordance with SFAS 142, Goodwill and Other Intangible Assets, the Company completed annual impairment tests as of November 30, 2004, 2003, and 2002, and will be subject to an impairment test each year thereafter and whenever there is an impairment indicator. The Company's annual impairment testing corresponds with the Company's determination of its annual operating budgets for the upcoming year. The Company's valuation of goodwill is based on a discounted cash flow model applying an appropriate discount rate to future expected cash flows and management's annual review of historical data and future assessment of certain critical operating factors, including, car wash volumes, average car

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

wash and detailing revenue rates per car, wash and detailing labor cost percentages, weather trends and recent and expected operating cost levels. Estimating cash flows requires significant judgment including factors beyond our control and our projections may vary from cash flows eventually realized. Adverse business conditions could affect recoverability of goodwill in the future and accordingly, the Company may record additional impairments in subsequent years.

OTHER INTANGIBLE ASSETS

Other intangible assets consist primarily of deferred financing costs, customer lists, product lists, trademarks, and a registered national brand name. In accordance with SFAS 142, Goodwill and Other Intangible Assets, our trademarks and brand name are considered to have indefinite lives, and as such, are not subject to amortization. These assets are tested for impairment using discounted cash flow methodology annually and whenever there is an impairment indicator. Estimating future cash flows requires

15

significant judgment and projections may vary from cash flows eventually realized. Several impairment indicators are beyond our control, and cannot be predicted with any certainty whether or not they will occur. Deferred financing costs are amortized on a straight-line basis over the terms of the respective debt instruments. Customer lists, product lists, and non-compete agreements are amortized on a straight-line basis over their respective estimated useful lives.

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 (benefit) represents the change during the period in the deferred income tax assets and deferred income tax liabilities. Deferred income 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 income tax assets will not be realized.

SUPPLEMENTARY CASH FLOW INFORMATION

Interest paid on all indebtedness was approximately \$504,000 and \$486,000 for the quarter ended March 31, 2005 and 2004, respectively. Income taxes paid were \$0 in the first quarter of 2005 and a refund of \$67,000 was received in the first quarter of 2004.

INTRODUCTION

REVENUES

CAR AND TRUCK WASH 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 three months ended March 31, 2005 for the Car and Truck Wash Segment were comprised of approximately 83% car wash and detailing, 8% lube and other automotive services, and 9% fuel and merchandise.

The majority of revenues are collected in the form of cash or credit card

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

receipts, thus minimizing customer accounts receivable.

Weather has had a significant impact on volume, and therefore revenue at the individual locations. We believe that the geographic diversity of our operating locations in different regions of the country helps mitigate the risk of adverse weather-related influence on our volume.

SECURITY

Our Security Segment designs, manufactures, markets and sells a wide range of products. The Company's primary focus in the Security Segment is the design of electronic video surveillance systems and components that it produces and sells, primarily to installing dealers, system integrators and end users. Other products in our Security Segment include, but are not limited to, less-than-lethal defense sprays, personal alarms, biometric locks and plasma monitors. The main marketing channels for our products are industry shows, outside sales representatives, catalogs, internet, sales through a call center and sales through mass merchants and trade publications.

COST OF REVENUES

CAR AND TRUCK WASH SERVICES

Cost of revenues consists primarily of direct labor and related taxes and fringe benefits, certain insurance costs, 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.

16

SECURITY

Cost of revenues within the Security Segment consists primarily of costs to purchase or manufacture the security products including direct labor and related taxes and fringe benefits, and raw material costs. Product warranty costs related to the Security Segment have been minimal in that the majority of customer product warranty claims are reimbursed by the supplier.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative ("SG&A") 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 business acquisitions. Indirect acquisition costs, such as executive salaries, corporate overhead, public relations, and other corporate services and overhead are expensed as incurred.

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.

OTHER INCOME

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

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 property and 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 of 36% differs from the federal statutory rate primarily due to state and local income taxes, non-deductible costs related to acquired intangibles, fixed asset adjustments and changes to the valuation allowance.

LIQUIDITY AND CAPITAL RESOURCES

LIQUIDITY

Cash and cash equivalents were \$13.0 million at March 31, 2005. The ratio of our total debt to total capitalization, which consists of total debt plus stockholders' equity, was 29.8% at March 31, 2005, and 30.5% at December 31, 2004.

Our business requires a substantial amount of capital, most notably to pursue our expansion strategies, including our current expansion in the Security Segment, and for equipment purchases and upgrades for our Car and Truck Wash 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 is at a desirable level.

As of March 31, 2005, we had working capital of approximately \$16.6 million. At December 31, 2004, working capital was approximately \$17.5 million.

During the three month periods ending March 31, 2005 and 2004, we made capital expenditures of \$276,000 and \$136,000, respectively, within our Car and Truck Wash Segment. We estimate aggregate capital expenditures for our Car and Truck Wash Segment, exclusive of acquisitions of businesses, of approximately \$1.0 million for the remainder of the year ending December 31, 2005. The Company believes its current cash balance at March 31, 2005 of \$13.0 million and cash flow from operating activities in the remainder of 2005 will be sufficient to meet its car wash capital expenditure funding needs through at least the next twelve months. In years subsequent to 2005, we estimate that our Car and Truck Wash Segment will require annual capital expenditures of \$750,000 to \$1.25 million. Capital expenditures within our Car and Truck Wash Segment are necessary to maintain the efficiency and competitiveness of our sites. If the cash provided from operating activities does not improve in 2005

17

and future years and if current cash balances are depleted, we will need to raise additional capital to meet these ongoing capital requirements.

We have spent approximately \$4.9 million through June 30, 2004 in developing our video surveillance systems operations in Ft. Lauderdale, Florida including the acquisition costs of Micro-Tech and Vernex and the cost of developing and purchasing inventory for our expanded product line. Additionally, on July 1, 2004 the Company paid approximately \$5.6 million of cash for the acquisition of the S&M and IVS security operations. We also made capital expenditures of approximately \$1.9 million for the purchase and furnishing of a new facility in Farmers Branch, Texas for our newly acquired S&M and IVS security operations. Approximately \$825,000 of the Farmers Branch, Texas facility purchase price was financed with debt. We estimate capital expenditures for the Security Segment at approximately \$100,000 for the remainder of 2005, principally related to

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

improvements and equipment for the new facilities in Farmers Branch, Texas and Ft. Lauderdale, Florida.

We intend to continue to expend significant cash for the purchase of inventory as we grow and introduce new video surveillance products in 2005 and in years subsequent to 2005. We anticipate that inventory purchases will be funded from cash collected from sales and working capital. At March 31, 2005, we maintained an unused \$500,000 revolving credit facility with Bank One to provide financing for additional video surveillance product inventory purchases. This revolving credit facility is subject to an availability calculation based on inventory and accounts receivable (as defined in our bank agreement). Based upon availability calculations at March 31, 2005, the full amount of the revolving credit facility is currently available. The amount of capital that we will spend in 2005 and in years subsequent to 2005 is largely dependent on the marketing success we achieve with our video surveillance systems and components. We believe our cash balance of \$13.0 million at March 31, 2005 and the revolving credit facility will provide for growth in 2005. Unless our operating cash flow improves, our growth will be limited if we deplete our cash balance.

In the past, we have been successful in obtaining financing by selling common stock and obtaining mortgage loans. Our ability to obtain new financing can be adversely impacted by our stock price. Our failure to maintain the required current debt service coverage ratios on existing loans also adversely impacts our ability to obtain additional financing. We are reluctant to sell common stock at market prices below our per share book value. For the twelve month period ended March 31, 2005 we were in default on certain of our debt covenants. We obtained waivers through April 1, 2006 from the lenders. Our ability to obtain new financing will be limited if our stock price is not above our per share book value and our cash from operating activities does not improve. Currently, we cannot incur additional long term debt without the approval of one of our commercial lenders. The Company must demonstrate that the cash flow benefit from the use of new loan proceeds exceeds the resulting future debt service requirements.

DEBT CAPITALIZATION AND OTHER FINANCING ARRANGEMENTS

At March 31, 2005, we had borrowings, including capital lease obligations, of approximately \$28.3 million. We had three letters of credit outstanding at March 31, 2005, totaling \$1.1 million as collateral relating to workers' compensation insurance policies. We maintain a \$500,000 revolving credit facility, subject to an availability calculation based on inventory and accounts receivable, to provide financing for additional video surveillance product inventory purchases. There were no borrowings outstanding under the revolving credit facility at March 31, 2005. The Company also maintains a \$600,000 line of credit for commercial letters of credit for the importation of inventory. There were no outstanding commercial letters of credit under this commitment at March 31, 2005.

Several of our debt agreements, as amended, contain certain affirmative and negative covenants and require the maintenance of certain levels of tangible net worth, maintenance of certain unencumbered cash and marketable securities balances, limitations on capital spending and the maintenance of certain debt service coverage ratios on a consolidated level.

At March 31, 2005, we were not in compliance with our semi-annual consolidated debt coverage ratio of at least 1.25:1 related to our GMAC notes payable. The Company's debt coverage ratio related to the GMAC notes payable was .89:1 at March 31, 2005. GMAC granted us a waiver of acceleration related to the non-compliance with the debt coverage ratio covenant at March 31, 2005, and for measurement periods through April 1, 2006 and, accordingly, a portion of the GMAC notes payable was reflected as non-current on our financial statements at March 31, 2005. If we are not able to achieve a debt coverage ratio of at least

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

1.25:1, or we cannot obtain further waivers of acceleration, the GMAC notes may be reflected as current in future balance sheets and as a result our stock price may decline.

18

The Company entered into amendments to the Bank One term loan agreements effective March 31, 2004. The amended debt coverage ratio with Bank One requires the Company to maintain a ratio of consolidated earnings before interest, income taxes, depreciation and amortization to debt service of 1.05:1 at March 31, 2004 and thereafter. The Company's debt coverage ratio was .86:1 at March 31, 2005, which was not in compliance with this Bank One covenant as amended. The Company received a waiver of acceleration with respect to this debt coverage ratio from Bank One through April 1, 2006 and, accordingly, a portion of the Bank One notes payable was reflected as non-current on our financial statements at March 31, 2005. The Bank One amendment also requires the maintenance of a minimum total unencumbered cash and marketable securities balance of \$5 million. This cash balance requirement will be lowered to \$1 million upon the Company returning to a debt coverage ratio of at least 1.10 to 1. If we are unable to satisfy these covenants or obtain further waivers, the Bank One notes may be reflected as current in future balance sheets and as a result our stock price may decline.

The Company sold two unprofitable or marginally profitable car wash facilities in 2004 and increased its prices in March 2004 within the Car and Truck Wash Segment to help improve cash flows. The Company's ongoing ability to comply with its debt covenants under its credit arrangements and refinance its debt depends largely on the achievement of adequate levels of cash flow. If our future cash flows are less than expected or debt service including interest expense increases more than expected causing us to further default on any of the Bank One covenants or the GMAC covenant in the future, the Company will need to obtain further amendments or waivers from these lenders. Our cash flow has been and could continue to be adversely affected by weather patterns, economic conditions, and the requirements to fund the growth of our security business. In the event that non-compliance with the debt covenants should reoccur, the Company would pursue various alternatives to attempt to successfully resolve the non-compliance, which might include, among other things, seeking additional debt covenant waivers or amendments, or refinancing debt with other financial institutions. If the Company is unable to obtain waivers or amendments in the future, Bank One debt currently totaling \$14.2 million and GMAC debt currently totaling \$10.4 million, including debt recorded as long-term debt at March 31, 2005, would become payable on demand by the financial institution upon expiration of the current waivers. There can be no assurance that further debt covenant waivers or amendments would be obtained or that the debt would be refinanced with other financial institutions at favorable terms. If we are unable to obtain renewals on maturing loans or refinancing of loans on favorable terms, our ability to operate would be materially and adversely affected.

The Company is obligated under various operating leases, primarily for certain equipment and real estate within the Car and Truck Wash Segment. Certain of these leases contain purchase options, renewal provisions, and contingent rentals for our proportionate share of taxes, utilities, insurance, and annual cost of living increases.

19

The following are summaries of our contractual obligations and other commercial commitments at March 31, 2005 (in thousands):

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

Contractual Obligations (1)	Payments Due By Period				
	Total	Less than One Year	Two to Three Years	Four to Five Years	More Than Five Years
Long-term debt (2)	\$ 28,145	\$ 2,487	\$ 5,095	\$ 12,700	\$ 7,863
Capital leases (2)	137	69	68	-	-
Minimum operating lease payments	3,914	1,034	1,274	717	-
	<u>\$ 32,196</u>	<u>\$ 3,590</u>	<u>\$ 6,437</u>	<u>\$ 13,417</u>	<u>\$ 7,863</u>

Other Commercial Commitments	Amounts Expiring Per Period				
	Total	Less Than One Year	Two to Three Years	Four to Five Years	More Than Five Years
Line of credit (3)	\$ 500	\$ 500	\$ -	\$ -	\$ -
Standby letters of credit (4)	1,078	1,078	-	-	-
	<u>\$ 1,578</u>	<u>\$ 1,578</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

- (1) Potential amounts for inventory ordered under purchase orders are not reflected in the amounts above as they are typically cancelable prior to delivery and, if purchased, would be sold within the normal business cycle.
- (2) Related interest obligations have been excluded from this maturity schedule. Our interest payments for the next twelve month period, based on current market rates, are expected to be approximately \$1.95 million.
- (3) There were no borrowings outstanding under the Company's line of credit at March 31, 2005.
- (4) The Company also maintains a \$600,000 line of credit for commercial letters of credit for the importation of inventory. There were no outstanding commercial letters of credit under this commitment at March 31, 2005. Outstanding letters of credit of \$1,078,000 represent collateral for workers' compensation insurance policies

Mace currently employs Louis D. Paolino, Jr. as its President and Chief Executive Officer under a three-year employment agreement dated August 12, 2003. The principal terms of the employment agreement include: an annual salary of \$400,000; a car at a lease cost of \$1,500 per month; provision for certain medical and other employee benefits; prohibition against competing with Mace during employment and for a three-month period following a termination of employment; and a \$2.5 million payment in the event that Mr. Paolino's employment is terminated for certain reasons set forth in the employment agreement. The termination payment is not due in the event of termination due to death or disability or certain prohibited conduct, as more fully set forth in the employment agreement. The termination payment is due if Mr. Paolino is terminated for unsatisfactory job performance. The employment agreement also entitles Mr. Paolino to a \$2.5 million change-of-control bonus.

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

The Master Facility Agreement between the Company and Fusion Capital Fund II, LLC ("Fusion") and the Equity Purchase Agreement between the Company and Fusion has been terminated. Under the Master Facility Agreement, the Company had entered into an Equity Purchase Agreement on April 17, 2000. Under the Equity Purchase Agreement, Fusion had the right and obligation to purchase up to \$10 million of the Company's common stock under certain conditions. On April 21, 2004, the Company and Fusion entered into a termination and release agreement under which the Company sold Fusion 150,000 registered shares of the Company's common stock at \$2.32 per share and terminated the Equity Purchase Agreement.

CASH FLOWS

Operating Activities. Net cash used in operating activities totaled \$566,000 for the three months ended March 31, 2005. Cash used in operating activities in 2005 was primarily due to an increase in our inventories of our Security Segment of \$770,000 and a decrease in accounts payable of \$846,000 primarily due to the payment of real estate taxes in the first quarter of 2005. Net cash provided by operating activities totaled \$1.0 million for the three months ended March 31, 2004. Cash provided by operating

20

activities in 2004 was primarily due to positive operating results and a reduction of inventory within the Company's Security Segment.

Investing Activities. Cash used in investing activities totaled \$7,000 for the three months ended March 31, 2005, which includes capital expenditures of \$396,000 and proceeds of \$390,000 from the sale of an unused warehouse bay in one of our Florida facilities. Cash used in investing activities totaled \$170,000 for the three months ended March 31, 2004 which includes \$135,000 for capital expenditures relating to ongoing car care operations, and \$6,000 for the Security Segment.

Financing Activities. Cash used in financing activities was \$964,000 for the three months ended March 31, 2005, which includes routine principal payments on debt of \$575,000 and payoff of \$338,000 of debt utilizing proceeds from the previously mentioned sale of a warehouse bay. Cash used in financing activities was \$634,000 for the three months ended March 31, 2004, which includes routine principal payments on debt of \$660,000 partially offset by \$26,000 of proceeds from the issuance of common stock.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2005 COMPARED TO THE THREE MONTHS ENDED MARCH 31, 2004

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

	THREE MONTHS ENDED MARCH 31,	
	2005	2004
Revenues	100.0%	100.0%
Cost of revenues	72.8	71.0
Selling, general and administrative expenses	21.4	19.5

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

Depreciation and amortization	3.5	3.9
	-----	-----
Operating income	2.3	5.6
Interest expense, net	(2.7)	(3.8)
Other income	0.5	0.9
	-----	-----
Income before income taxes	0.1	2.7
Income tax expense	-	1.0
	-----	-----
Net income	0.1%	1.7%
	=====	=====

REVENUES

CAR AND TRUCK WASH SERVICES

Revenues for the three months ended March 31, 2005 were \$10.5 million as compared to \$10.8 million for the three months ended March 31, 2004, a decrease of \$0.3 million or 3%. This decrease was primarily attributable to a decrease in wash and detail services. Of the \$10.5 million of revenues for the three months ended March 31, 2005, \$8.7 million or 83% was generated from car wash and detailing, \$791,000 or 8% from lube and other automotive services, and \$983,000 or 9% from fuel and merchandise sales. Of the \$10.8 million of revenues for the three months ended March 31, 2004, \$8.9 million or 82% was generated from car wash and detailing, \$0.9 million or 9% from lube and other automotive services, and \$1.0 million or 9% from fuel and merchandise sales. The decrease in wash and detail revenues was principally due to closing or divesting of two of our car wash locations in 2004; and unfavorable weather trends within our Arizona and Texas regions. Overall car wash volumes declined 3.4% in the first quarter of 2005 as compared to the first quarter of 2004, including 2.3% from the closing or divesting of the two car wash locations noted above. Partially offsetting this decline in volume, the Company experienced an increase in average wash and detailing revenue per car to \$14.73 in the first quarter of 2005, from \$14.42 in the same period in 2004. This increase in average wash and detailing revenue per car was the result of management's continued focus on aggressively selling detailing and additional on-line car wash services. The increase in fuel and merchandise revenues is primarily the result of the addition of higher quality merchandise in our car wash lobbies. Management expects car wash volumes to increase as weather trends return to more

21

historic levels of inclement weather resulting in an improvement in car wash and detailing revenue levels.

SECURITY

Revenues within the Security Segment were approximately \$6.4 million and \$1.9 million for the three months ended March 31, 2005 and 2004, respectively. The increase in revenues within the Security Segment was due principally to internal growth in sales to security system installers, and \$3.5 million of sales generated by IVS and S&M which we acquired in July of 2004. Management expects revenues to continue to increase in the electronic surveillance systems area as the Company expands its sales staff and marketing efforts.

COST OF REVENUES

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

CAR AND TRUCK WASH SERVICES

Cost of revenues for the three months ended March 31, 2005 were \$7.7 million, or 73% of revenues, with car washing and detailing costs at 71% of respective revenues, lube and other automotive services costs at 83% of respective revenues, and fuel and merchandise costs at 87% of respective revenues. Cost of revenues for the three months ended March 31, 2004 were \$7.8 million, or 72% of revenues, with car washing and detailing costs at 71% of respective revenues, lube and other automotive services costs at 76% of respective revenues, and fuel and merchandise costs at 86% of respective revenues.

SECURITY

During the three months ended March 31, 2005 cost of revenues were \$4.6 million or 72% of revenues as compared to \$1.2 million or 63% of revenues for the three months ended March 31, 2004. The increase in cost of revenues in 2005 is principally due to the growth in the sale of video surveillance systems and components which have gross profit margins typically lower than less-than-lethal defense sprays; an increase in sales to larger distributors and system installers at lower profit margins to gain market share; and the acquisition of IVS and S&M with sales margins lower than the Company's previously existing security operations.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the three months ended March 31, 2005 were \$3.6 million compared to \$2.5 million for the same period in 2004. SG&A expenses as a percent of revenues were 21.4% for the three months ended March 31, 2005 as compared to 19.5% in the first quarter of 2004. The increase in SG&A costs is primarily the result of the growth in the Security Segment which added an additional \$1.0 million of SG&A costs in 2005. Management does not expect SG&A costs as a percent of revenues to substantially increase in the future.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization totaled \$590,000 for the three months ended March 31, 2005 as compared to \$500,000 for the same period in 2004.

INTEREST EXPENSE, NET

Interest expense, net of interest income, for the three months ended March 31, 2005 was \$451,000 compared to \$479,000 for the three months ended March 31, 2004. This decrease in interest expense was the result of a reduction in our outstanding debt as a result of normal principal payments, partially offset by an increase in interest rates on approximately 50% of our long term debt which has interest rates tied to the prime rate and an increase in interest income.

OTHER INCOME

Other income for the three months ended March 31, 2005 was \$89,000 compared to \$112,000 for the three months ended March 31, 2004.

INCOME TAXES

The Company recorded tax expense of \$6,000 and \$122,000 for the three months ended March 31, 2005 and 2004, respectively. Tax expense reflects the recording of income taxes at an effective rate of approximately 36% in both 2005 and 2004.

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

The effective rate differs from the federal statutory rate for each year primarily due to state and local income taxes, non-deductible costs related to intangibles, fixed asset adjustments and changes to the valuation allowance.

RISK FACTORS

FACTORS INFLUENCING FUTURE RESULTS AND ACCURACY OF 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 report 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 be 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 important 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 important 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.

IF WE DO NOT RAISE ADDITIONAL CAPITAL, WE MAY NEED TO SUBSTANTIALLY REDUCE THE SCALE OF OUR OPERATIONS AND CURTAIL OUR BUSINESS PLAN.

Our business plan involves growing through acquisitions and internal development, each of which requires significant capital. Our capital requirements also include working capital for daily operations and significant capital for equipment purchases. Although we had positive working capital of \$16.6 million as of March 31, 2005, we have a history of net losses and in some years we have ended our fiscal year with a negative working capital balance. To the extent that we lack cash to meet our future capital needs, we will need to raise additional funds through bank borrowings and significant additional equity and/or debt financings, which may result in significant increases in leverage and interest expense and/or substantial dilution of our outstanding equity. If we are unable to raise additional capital, we may need to substantially reduce the scale of our operations and curtail our business plan.

IF WE ARE NOT ABLE TO MANAGE GROWTH, OUR BUSINESS PLAN MAY NOT BE REALIZED.

Our business objectives include developing our Security Segment, both internally and through acquisitions, if we can do so under advantageous terms. As such, our business plan is predicated on growth. If we succeed in growing, it will place significant burdens on our management and on our operational and other resources. For example, it may be difficult to assimilate the operations and personnel of an acquired business into our existing business; we must integrate management information and accounting systems of an acquired business into our current systems; our management must devote its attention to assimilating the acquired business, which diverts attention from other business concerns; we may enter markets in which we have limited prior experience; and we may lose key

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

employees of an acquired business. We will also need to attract, train, motivate, retain, and supervise senior managers and other employees. If we fail to manage these burdens successfully, one or more of the acquisitions could be unprofitable, the shift of our management's focus could harm our other businesses, and we may be forced to abandon our business plan, which relies on growth.

23

IF WE VIOLATE THE FINANCIAL COVENANTS WITH OUR LENDERS, OUR BORROWINGS MAY BE ACCELERATED.

Our bank debt borrowings as of March 31, 2005 were \$28.3 million substantially all of which is secured by mortgages against certain of our real property. Of such borrowings, \$2.6 million is classified as current as it is due in less than 12 months from March 31, 2005. Our two most significant borrowings are secured notes payable to General Motors Acceptance Corp. ("GMAC") in the amount of \$10.4 million, \$9.5 million of which was classified as non-current debt at March 31, 2005, and secured notes payable to Bank One, Texas, N.A. ("Bank One") in the amount of \$14.2 million, \$12.8 million of which was classified as non-current debt at March 31, 2005. The GMAC and Bank One agreements contain affirmative and negative covenants, including the maintenance of certain levels of tangible net worth, maintenance of certain levels of unencumbered cash and marketable securities, limitations on capital spending and the maintenance of certain debt coverage ratios on a consolidated level. The Bank One agreement is our only debt agreement that contains an express prohibition on incurring additional debt for borrowed money without the approval of the lender. None of our other agreements contain such a prohibition. Twenty five car wash facilities, one truck wash facility and our warehouse and office in Farmers Branch, Texas are encumbered by mortgages.

At March 31, 2005, we were not in compliance with our semi-annual consolidated debt coverage ratio of at least 1.25:1 related to our GMAC notes payable. The Company's debt coverage ratio related to the GMAC notes payable was .89:1 at March 31, 2005. GMAC granted us a waiver of acceleration related to the non-compliance with the debt coverage ratio covenant at March 31, 2005, and for measurement periods through April 1, 2006 and, accordingly, a portion of the GMAC notes payable was reflected as non-current on our financial statements at March 31, 2005. If we are not able to achieve a debt coverage ratio of at least 1.25:1, or we cannot obtain further waivers of acceleration, the GMAC notes may be reflected as current in future balance sheets and as a result our stock price may decline.

The Company entered into amendments to the Bank One term loan agreements effective March 31, 2004. The amended debt coverage ratio with Bank One requires the Company to maintain a ratio of consolidated earnings before interest, income taxes, depreciation and amortization to debt service of 1.05:1 at March 31, 2004 and thereafter. The Company's debt coverage ratio related to the Bank One term loan agreement was .86:1 at March 31, 2005, which was not in compliance with this Bank One covenant as amended. The Company received a waiver of acceleration with respect to this debt coverage ratio from Bank One through April 1, 2006 and, accordingly, a portion of the Bank One notes payable was reflected as non-current on our financial statements at March 31, 2005. The Bank One amendment also requires the maintenance of a minimum total unencumbered cash and marketable securities balance of \$5.0 million. This cash balance requirement will be lowered to \$1 million upon the Company returning to a debt coverage ratio of at least 1.10:1. If we are unable to satisfy these covenants or obtain further waivers, the Bank One notes may be reflected as current in future balance sheets and as a result our stock price may decline.

Our ongoing ability to comply with the debt covenants under our credit

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

arrangements and refinance our debt depends largely on our achievement of adequate levels of cash flow. Our cash flow has been and could continue to be adversely affected by weather patterns and economic conditions. In the future, if our cash flows are less than expected or debt service, including interest expense, increases more than expected, we may continue to be out of compliance with the Bank One and GMAC covenants and need to seek additional waivers or amendments.

If we default on any of the Bank One or GMAC covenants and are not able to obtain further amendments or waivers of acceleration, Bank One debt totaling \$14.2 million and GMAC debt totaling \$10.4 million, including debt recorded as long-term debt at March 31, 2005, could become due and payable on demand, and Bank One and/or GMAC could foreclose on the assets pledged in support of the relevant indebtedness. If our assets (including up to 25 of our car wash facilities and one truck wash) are foreclosed upon, revenues from our Car and Truck Wash Segment, which comprised 62% of our total revenues for the quarter ended March 31, 2005, would be severely impacted and we could be unable to continue to operate our business. Even if the debt were accelerated without foreclosure, it would be very difficult for us to continue to operate our business and we may go out of business.

WE HAVE REPORTED NET LOSSES IN THE PAST. IF WE CONTINUE TO REPORT NET LOSSES, THE PRICE OF OUR COMMON STOCK MAY DECLINE, OR WE COULD GO OUT OF BUSINESS.

For the year ended December 31, 2004, we reported a net loss although our business as a whole generated positive cash flow from operations. The majority of the reported losses in 2004 related to non-cash impairment charges of intangible assets, particularly goodwill, in accordance with SFAS 142, Goodwill and Other Intangible Assets. Under SFAS 142, which became effective 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. As a result, we may be required to record additional impairments in the future, which could materially reduce our earnings and equity.

24

IF WE LOSE THE SERVICES OF OUR EXECUTIVE OFFICERS, OUR BUSINESS MAY SUFFER.

If we lose the services of one or more of our executive officers and do not replace them with experienced personnel, that loss of talent and experience will make our business plan, which is dependent on active growth and management, more difficult to implement. The employment agreements of Robert M. Kramer, Gregory M. Krzemien, and Ronald R. Pirollo expired on March 26, 2003. Mr. Kramer is the chief operating officer of our Car and Truck Wash Segment, and our general counsel and secretary; Mr. Krzemien is our chief financial officer and treasurer; and Mr. Pirollo is our chief accounting officer and corporate controller. Messrs. Kramer and Krzemien are working on a month-to-month at-will basis, and Mr. Pirollo is working on an at-will basis. Without employment contracts, we may lose the services of any one or more of Messrs. Kramer, Krzemien and Pirollo, each of whom has been involved in our management for several years and would be difficult to replace. In addition, we do not maintain key-man life insurance policies on our executive officers.

IF OUR INSURANCE IS INADEQUATE, WE COULD FACE SIGNIFICANT LOSSES.

We maintain various insurance coverages for our assets and operations. These coverages include property coverages including business interruption protection for each location. We maintain commercial general liability coverage in the amount of \$1 million per occurrence and \$2 million in the aggregate with an

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

umbrella policy which provides coverage up to \$25 million. We also maintain workers' compensation policies in every state in which we operate. Commencing July 2002, as a result of increasing costs of the Company's insurance program, including auto, general liability, and workers' compensation coverage, we are insured through participation in a captive insurance program with other unrelated businesses. The Company maintains excess coverage through occurrence-based policies. With respect to our auto, general liability, and workers' compensation policies, we are required to set aside an actuarial determined amount of cash in a restricted "loss fund" account for the payment of claims under the policies. We expect to fund these accounts annually as required by the insurance company. Should funds deposited exceed claims incurred and paid, unused deposited funds are returned to us with interest on the third anniversary of the policy year-end. The captive insurance program is further secured by a letter of credit in the amount of \$973,000 at March 31, 2005. The Company records a monthly expense for losses up to the reinsurance limit per claim based on the Company's tracking of claims and the insurance company's reporting of amounts paid on claims plus their estimate of reserves for possible future payments. There can be no assurance that our insurance will provide sufficient coverage in the event a claim is made against us, or that we will be able to maintain in place such insurance at reasonable prices. An uninsured or under insured claim against us of sufficient magnitude could have a material adverse effect on our business and results of operations.

RISKS RELATED TO OUR SECURITY SEGMENT

IF WE ARE NOT ABLE TO OPERATE OUR ELECTRONIC SURVEILLANCE PRODUCTS DIVISION EFFECTIVELY, OUR BUSINESS WILL SUFFER.

In 2001, we expanded our Security Segment by adding video systems and components. We are incurring expenses to develop and further expand these products. There are numerous risks associated with expanding our video surveillance systems and components that may prevent us from operating the Security Segment profitably, including, among others: risks associated with products which do not function properly; risks associated with unanticipated liabilities of the acquired companies; risks inherent with our management having limited experience in the electronic surveillance product market; risks relating to the size and number of competitors in the video system and component product market, many of whom may be more experienced or better financed; risks associated with the costs of entering into new markets and expansion of product lines in existing markets; risks associated with rapidly evolving technology and having inventory become obsolete; risks associated with purchasing inventory before having orders for that inventory; risks attendant to locating and maintaining reliable sources of OEM products and component supplies in the electronic surveillance industry; risks related to retaining key employees involved in future technology development and communications with OEM suppliers; and risks associated with developing and introducing new products in order to maintain competitiveness in a rapidly changing marketplace. We also expect that there will be costs related to product returns and warranties and customer support that we cannot quantify or accurately estimate until we have more experience in operating the electronic surveillance product division. If we are not able to operate our electronic surveillance products division effectively, our operating and financial results could be adversely impacted.

WE COULD BECOME SUBJECT TO LITIGATION REGARDING INTELLECTUAL PROPERTY RIGHTS, WHICH COULD SERIOUSLY HARM OUR BUSINESS.

Although we have not been the subject of any such actions, third parties may in the future assert against us infringement claims or claims that we have violated a patent or infringed upon a copyright, trademark or other proprietary right belonging to them. We design most of our security products and contract with independent suppliers to manufacture those products and deliver them to us. Certain of these products contain proprietary intellectual property of these

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

independent suppliers. Third parties may in the future assert claims against our suppliers that such suppliers have violated a patent or infringed upon a copyright, trademark or

25

other proprietary right belonging to them. If such infringement by our suppliers or us were found to exist, a party could seek an injunction preventing the use of their intellectual property. In addition, if an infringement by us were found to exist, we may attempt to acquire a license or right to use such technology or intellectual property. Most of our suppliers have agreed to indemnify us against any such infringement claim, but any infringement claim, even if not meritorious and/or covered by an indemnification obligation, could result in the expenditure of a significant amount of our financial and managerial resources.

IF OUR ORIGINAL EQUIPMENT MANUFACTURERS FAIL TO ADEQUATELY SUPPLY OUR PRODUCTS, OUR SECURITY PRODUCTS SALES MAY SUFFER.

Our products are manufactured on an OEM basis. Reliance upon OEMs, as well as industry supply conditions, generally involves several risks, including the possibility of defective products (which can adversely affect our reputation for reliability), a shortage of components and reduced control over delivery schedules (which can adversely affect our distribution schedules), and increases in component costs (which can adversely affect our profitability).

We have some single-sourced manufacturer relationships, either because alternative sources are not readily or economically available or because the relationship is advantageous due to performance, quality, support, delivery, capacity, or price considerations. If these sources are unable or unwilling to manufacture our products in a timely and reliable manner, we could experience temporary distribution interruptions, delays, or inefficiencies, adversely affecting our results of operations. Even where alternative OEMs are available, qualification of the alternative manufacturers and establishment of reliable suppliers could result in delays and a possible loss of sales, which could affect operating results adversely.

IF PEOPLE ARE INJURED BY OUR CONSUMER SAFETY PRODUCTS, WE COULD BE HELD LIABLE AND FACE DAMAGE AWARDS.

We face claims of injury allegedly resulting from our defense sprays, which we market as less-than-lethal. For example, we are aware of allegations that defense sprays used by law enforcement personnel resulted in deaths of prisoners and of suspects in custody. In addition to use or misuse by law enforcement agencies, the general public may pursue legal action against us based on injuries alleged to have been caused by our products. We may also face claims by purchasers of our electronic surveillance systems, if they fail to operate properly during the commission of a crime. As the use of defense sprays and electronic surveillance systems by the public increase, we could be subject to additional product liability claims. We have a \$25,000 deductible on our insurance policy, meaning that all such lawsuits, even unsuccessful ones, and ones covered by insurance, cost the company money. Furthermore, if our insurance coverage is exceeded, we will have to pay the excess liability directly. Our product liability insurance provides coverage of up to \$26 million per occurrence. However, if we are required to directly pay a claim in excess of our coverage, our income will be significantly reduced, and in the event of a large claim, we could go out of business.

IF GOVERNMENTAL REGULATIONS CHANGE OR ARE APPLIED DIFFERENTLY, OUR BUSINESS COULD SUFFER.

The distribution, sale, ownership and use of consumer defense sprays are legal

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

in some form in all 50 states and the District of Columbia. Restrictions on the manufacture or use of consumer defense sprays may be enacted, which would severely restrict the market for our products or increase our costs of doing business.

Some of our consumer defense spray manufacturing operations currently incorporate hazardous materials, the use and emission of which are regulated by various state and federal environmental protection agencies, including the United States Environmental Protection Agency. We believe that we are in compliance with all current state and local statutes governing our handling and disposal of these hazardous materials, but if there are any changes in environmental permit or regulatory requirements, or if we fail to comply with any environmental requirements, these changes or failures may expose us to significant liabilities that would have a material adverse effect on our business and financial condition.

26

RISKS RELATED TO OUR CAR AND TRUCK WASH SEGMENT

IF CONSUMER DEMAND FOR OUR CAR WASH SERVICE DROPS, OUR BUSINESS WILL SUFFER.

Our revenues are primarily derived from our Car and Truck Wash Segment. As such, our financial condition and results of operations will depend substantially on continued consumer demand for car wash services. Our car wash 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. Also, seasonal trends in some areas 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. If there is a drop in consumer demand, our financial condition and results of operations will be adversely impacted.

WE FACE SIGNIFICANT COMPETITION AND IF WE CANNOT COMPETE EFFECTIVELY WE MAY LOSE MONEY AND THE VALUE OF OUR SECURITIES COULD DECLINE.

The car care industry is highly competitive. Competition is based primarily on location, customer service, available services, and price. We face competition from both inside and outside the car care industry, including gas stations, gasoline companies, automotive companies, specialty stores and convenience stores that offer automated car wash services. 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. In some cases, our competitors may have greater financial and operating resources than we do. If we cannot effectively compete, our operating results are likely to be negatively effected.

OUR CAR AND TRUCK WASH OPERATIONS FACE GOVERNMENTAL REGULATIONS, INCLUDING ENVIRONMENTAL REGULATIONS, AND IF WE FAIL TO OR ARE UNABLE TO COMPLY WITH THOSE REGULATIONS, OUR BUSINESS MAY SUFFER.

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. 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

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

of hazardous materials and wastes;

ii. discharge of storm water; and

iii. underground storage tanks.

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

Through our Car and Truck Wash Segment, we face a variety of potential environmental liabilities, including those arising out of improperly disposing waste oil or lubricants at our lube centers, improper maintenance of oil discharge ponds, which exist at two of our truck washes, and leaks from our underground gasoline storage tanks. If we improperly dispose of oil or other hazardous substances, or if our oil discharge ponds or underground gasoline tanks leak, we could be assessed fines by federal or state regulatory authorities and/or be required to remediate the property. Although each case is different, and there can be no assurance as to the cost to remediate an environmental problem, if any, at one of our properties, the costs for remediation and removal of a leaking discharge pond typically range from \$150,000 to \$200,000, and the costs for remediation of a leaking underground storage tank typically range from \$30,000 to \$75,000.

IF OUR CAR WASH EQUIPMENT IS NOT MAINTAINED, OUR CAR WASHES WILL NOT BE OPERABLE.

Many of our car washes have older equipment that requires frequent repair or replacement. Although we undertake to keep our car washing equipment in proper operating condition, the operating environment in car washes results in frequent mechanical problems. If we fail to properly maintain the equipment in a car wash, that car wash could become inoperable resulting in a loss of revenue.

27

RISK RELATED TO THE SALE OF OUR CAR AND TRUCK WASH SEGMENT

IF WE SELL OUR CAR AND TRUCK WASH SEGMENT, OUR REVENUES WILL DECREASE AND OUR BUSINESS MAY SUFFER.

On December 9, 2004, we engaged Legg Mason Wood Walker, Incorporated for the purpose of identifying strategic business alternatives, including the possible sale of all of our car and truck washes. We can offer no assurances that we will be able to locate potential buyers for our Car and Truck Wash Segment or that we will be able to consummate any sales to potential buyers we do locate. If we are able to sell our Car and Truck Wash Segment, our total revenues will decrease and our business will become reliant on the success of our Security Segment. Our Security Segment faces significant risks as set forth herein and may impact our ability to generate positive operating income or cash flows from operations, may cause our financial results to become more volatile, or may otherwise materially adversely affect us.

RISKS RELATED TO OUR STOCK

OUR STOCK PRICE HAS BEEN, AND LIKELY WILL CONTINUE TO BE, VOLATILE AND YOUR INVESTMENT MAY SUFFER A DECLINE IN VALUE.

The market prices for securities of companies quoted on The NASDAQ Stock Market, including our market price, have in the past been, and are likely to continue in

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

the future to be volatile. That volatility depends upon many factors, some of which are beyond our control, including:

announcements regarding the results of expansion or development efforts by us or our competitors;

- announcements regarding the acquisition of businesses or companies by us or our competitors;
- announcements regarding the disposition of all or a significant portion of the assets that comprise our Car and Truck Wash Segment, which may or may not be on favorable terms;
- technological innovations or new commercial products developed by us or our competitors;
- changes in our, or our suppliers', intellectual property portfolio;
- issuance of new or changed securities analysts' reports and/or recommendations applicable to us or our competitors;
- additions or departures of our key personnel;
- operating losses by us;
- actual or anticipated fluctuations in our quarterly financial and operating results and degree of trading liquidity in our common stock; and
- our ability to maintain our common stock listing on the NASDAQ National Market.

One or more of these factors could cause a decline in our revenues and income or in the price of our common stock, thereby reducing the value of an investment in our Company.

IF WE LOSE OUR LISTING ON THE NASDAQ NATIONAL MARKET, OUR STOCK WILL BECOME SIGNIFICANTLY LESS LIQUID AND ITS VALUE MAY BE AFFECTED.

Our common stock is listed on the NASDAQ National Market with a bid price of \$2.33 at the close of the market on May 6, 2005. Although the recent closing prices of our stock have been well in excess of \$1.00, in 2004 our stock traded at a price as low as \$1.78. If the price of our common stock falls below \$1.00 and for 30 consecutive days remains below \$1.00, we are subject to being delisted from the NASDAQ National Market. 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 \$1.00 for 30 consecutive days at which time we can regain our listing on the NASDAQ National Market. If our stock fails to maintain a minimum bid price of \$1.00 for 30 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 could receive a delisting notice from the NASDAQ SmallCap Market. Upon delisting from the NASDAQ SmallCap Market, our stock would 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"). Many OTC stocks trade less frequently and in smaller volumes than NASDAQ-Listed Stocks. Accordingly, our stock would be less liquid than it would otherwise be. Also, the values of these stocks may be more

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

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."

BECAUSE WE ARE A DELAWARE CORPORATION, IT MAY BE DIFFICULT FOR A THIRD PARTY TO ACQUIRE US, WHICH COULD AFFECT OUR STOCK PRICE.

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 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 premium for our common stock above its market price.

IF WE ISSUE OUR AUTHORIZED PREFERRED STOCK, THE RIGHTS OF THE HOLDERS OF OUR COMMON STOCK MAY BE AFFECTED AND OTHER ENTITIES MAY BE DISCOURAGED FROM SEEKING TO ACQUIRE CONTROL OF OUR COMPANY.

Our certificate of incorporation authorizes the issuance of up to 10 million shares of "blank check" preferred stock that could be designated and issued by our board of directors to increase the number of outstanding shares and thwart a takeover attempt. 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 holders of our preferred stock.

The "blank check" 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 a company more difficult or costly. Such an issuance, or the perceived threat of 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.

OUR POLICY OF NOT PAYING CASH DIVIDENDS ON OUR COMMON STOCK COULD NEGATIVELY AFFECT THE PRICE OF OUR COMMON STOCK.

We have not paid in the past, and do not expect to pay in the foreseeable future, cash dividends on our common stock. We expect to reinvest in our business any cash otherwise available for dividends. Our decision not to pay cash dividends may negatively affect the price of our common stock.

THERE ARE ADDITIONAL RISKS SET FORTH IN THE INCORPORATED DOCUMENTS. In

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

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 by us, and estimates at various times of our 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, 2004 as reported on our Form 10-K for the year ended December 31, 2004.

29

A significant portion of our debt is at fixed rates, and as such, changes in market interest rates would not significantly impact operating results unless and until such debt would need to be refinanced at maturity. Substantially all of our variable rate debt obligations are tied to the prime rate, as is our incremental borrowing rate. A one percent increase in the prime and Libor rates would not have a material effect on the fair value of our variable rate debt at March 31, 2005 and would have had the impact of increasing interest expense by approximately \$163,000 for the twelve months ended March 31, 2005.

On October 14, 2004, we entered into an interest rate cap that effectively changes our interest rate exposure on approximately \$7 million of variable rate debt. The variable rate debt floats at prime plus .25% (6.0% at March 31, 2005). The hedge contract has a 36-month term and caps the interest rate on the \$7 million of variable rate debt at 6.5%. The derivative is designated as a cash flow hedge and, accordingly, is marked to market with gains and losses on the contract reported as a component of other comprehensive income (loss) and is classified into earnings in the earlier of (i) the period the hedged transaction affects earnings, or (ii) the termination of the hedge contract. At March 31, 2005 the contract, which was originally purchased for \$124,000, is included in other assets at its fair market value of approximately \$120,000.

ITEM 4. CONTROLS AND PROCEDURES

Under the direction of our Chief Executive Officer and Chief Financial Officer, we evaluated our disclosure controls and procedures and internal control over financial reporting and concluded that (i) our disclosure controls and procedures were effective March 31, 2005, and (ii) no change in internal control over financial reporting occurred during the quarter ended March 31, 2005, that has materially affected, or is reasonably likely to materially affect, such internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information regarding our legal proceedings can be found in Note 6 Commitments and Contingencies.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table summarizes our equity security repurchases during the three

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

months ended March 31, 2005:

PERIOD	TOTAL NUMBER OF SHARES PURCHASED	AVERAGE PRICE PAID PER SHARE	TOTAL NUMBER OF SHARE PURCHASED AS PART OF PUBLICLY ANNOUNCED PLANS OR PROGRAMS	APPROXIMATE DOLLAR VALUE OF SHARES THAT YET BE PURCHASED UNDER THE PLANS OR PROGRAMS (\$)
-----	-----	-----	-----	-----
January 1 to January 31, 2005	-	-	-	\$ 3,000,000
February 1 to February 28, 2005	-	-	-	\$ 3,000,000
March 1 to March 31, 2005	-	-	-	\$ 3,000,000
Total	----- -	----- -	----- -	
	=====	=====	=====	

- (1) On July 29, 2004, the Company's Board of Directors approved a share repurchase program to allow the Company to repurchase up to an aggregate \$3,000,000 of its common shares in the future if market conditions so dictate. As of March 31, 2005, no shares had been repurchased under the program.

30

ITEM 6. EXHIBITS

(a) Exhibits:

- 10.1 Note Modification Agreement dated December 22, 2004 between the Company, its subsidiary, Mace Security Products Inc. and Bank One, Texas, N.A. in the amount of \$500,000.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

31

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the

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

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: May 10, 2005

32

EXHIBIT INDEX

EXHIBIT NO. -----	DESCRIPTION -----
10.1	Note Modification Agreement dated December 22, 2004 between the Company, its subsidiary and Bank One, Texas, N.A. in the amount of \$500,000.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as amended by Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as amended by Section 906 of the Sarbanes-Oxley Act of 2002.