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MACE SECURITY INTERNATIONAL INC
Form 10-Q
May 10, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTER ENDED MARCH 31, 2002

COMMISSION FILE NO. 0-22810

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

DELAWARE
(State or other jurisdiction of incorporation or organization)

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

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

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

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

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

As of May 7, 2002, there were 25,349,027 Shares of Registrant's Common Stock, par value \$.01 per share, outstanding.

Mace Security International, Inc.

Form 10-Q
Quarter Ended March 31, 2002

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Mace Security International, Inc.

Consolidated Balance Sheets

(In thousands except share information)

ASSETS	March 31, 2002	December 31, 2001
	-----	-----
	(Unaudited)	
Current assets:		
Cash and cash equivalents	\$ 6,943	\$ 6,612
Accounts receivable, less allowance for doubtful accounts of \$179 and \$178 in 2002 and 2001, respectively	852	1,075
Inventories	2,301	2,275
Deferred income taxes	153	145

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Prepaid expenses and other current assets	2,177	2,218
	-----	-----
Total current assets	12,426	12,325
Property and equipment:		
Land	32,592	32,592
Buildings and leasehold improvements	36,347	36,315
Machinery and equipment	8,878	8,776
Furniture and fixtures	442	431
	-----	-----
Total property and equipment	78,259	78,114
Accumulated depreciation and amortization	(7,683)	(7,204)
	-----	-----
Total property and equipment, net of accumulated depreciation and amortization	70,576	70,910
Excess of cost over net assets of acquired businesses, net of accumulated amortization of \$2,031	20,139	20,139
Other intangible assets, net of accumulated amortization of \$1,392 and \$1,384 in 2002 and 2001, respectively	918	993
Other assets	293	303
	-----	-----
Total assets	\$ 104,352	\$ 104,670
	=====	=====

See accompanying notes.

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LIABILITIES AND STOCKHOLDERS' EQUITY	March 31, 2002	December 31, 2001
	-----	-----
	(Unaudited)	
Current liabilities:		
Current portion of long-term debt and capital lease obligations	\$ 6,756	\$ 2,514
Accounts payable	1,987	2,446
Income taxes payable	235	174
Deferred revenue	216	257
Accrued expenses and other current liabilities	1,967	2,125
	-----	-----
Total current liabilities	11,161	7,516
Deferred income taxes	905	638
Long-term debt, net of current portion	26,806	31,570
Capital lease obligations, net of current portion	233	265
Other liabilities	825	825
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		

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Issued and outstanding shares of 25,349,027 and 25,428,427 in 2002 and 2001, respectively	253	254
Additional paid-in capital	69,897	69,977
Accumulated deficit	(5,728)	(6,375)
Total stockholders' equity	64,422	63,856
Total liabilities and stockholders' equity	\$ 104,352	\$ 104,670
	=====	=====

See accompanying notes.

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Mace Security International, Inc.

Consolidated Statements of Operations (Unaudited)

(In thousands except share information)

	Three Months Ended March 31	
	2002	2001
Revenues:		
Car wash and detailing services	\$ 9,966	\$ 9,966
Lube and other automotive services	1,035	1,035
Fuel and merchandise sales	695	695
Operating agreements	60	60
	11,756	11,756
Cost of revenues:		
Car wash and detailing services	6,526	6,526
Lube and other automotive services	789	789
Fuel and merchandise sales	601	601
	7,916	7,916
Selling, general and administrative expenses	1,793	1,793
Depreciation and amortization	472	472
Operating income	1,575	1,575
Interest expense, net	(563)	(563)
Other income	66	66
Income before income taxes	1,078	1,078
Income tax expense	388	388

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Income before cumulative effect of a change in accounting principle	\$	690	\$
Cumulative effect of a change in accounting principle, net of tax		43	
		-----	-----
Net income	\$	647	\$
		=====	=====
Per share of common stock:			
Basic income before cumulative effect of a change in accounting principle	\$	0.03	\$
Cumulative effect of a change in accounting principle, net of tax		-	
		-----	-----
Basic net income	\$	0.03	\$
		=====	=====
Diluted income before cumulative effect of a change in accounting principle	\$	0.03	\$
Cumulative effect of a change in accounting principle, net of tax		-	
		-----	-----
Diluted net income	\$	0.03	\$
		=====	=====
Weighted average shares outstanding:			
Basic		25,386,754	2
Diluted		25,436,763	2

See accompanying notes.

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Mace Security International, Inc.

Consolidated Statement of Stockholders' Equity (Unaudited)

(In thousands except share information)

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

See accompanying notes.

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

(In thousands)

	Three Months Ended March 31,	
	----- 2002 -----	2001 -----
Operating activities		
Net income	\$ 647	\$ 302
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	472	675
Deferred income taxes	259	144
Non-cash charge due to change in accounting principle	67	-
Changes in operating assets and liabilities:		
Accounts receivable	28	(72)
Inventories	(50)	36
Accounts payable	(482)	(182)
Deferred revenue	(48)	(136)
Accrued expenses	(154)	1
Income taxes	62	(30)
Prepaid expenses and other assets	308	43
	-----	-----
Net cash provided by operating activities	1,109	781
Investing activities		
Purchase of property and equipment	(133)	(247)
Proceeds from sale of property and equipment	-	466
Payments for intangibles	-	(3)
Deposits and other prepaid costs on future acquisitions	(10)	(7)
	-----	-----
Net cash (used in) provided by investing activities	(143)	209
Financing activities		
Payments on long-term debt and capital lease obligations	(554)	(421)
Payments to purchase stock	(81)	(2)
	-----	-----
Net cash used in financing activities	(635)	(423)
	-----	-----
Net increase in cash and cash equivalents	331	567
Cash and cash equivalents at beginning of period	6,612	4,838
	-----	-----
Cash and cash equivalents at end of period	\$ 6,943	\$ 5,405
	=====	=====

See accompanying notes.

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Mace Security International, Inc.

Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation and Principles of Consolidation

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

2. Significant Accounting Policies

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

- . All business combinations initiated after June 30, 2001 must use the purchase method of accounting. The pooling of interests method of accounting is prohibited except for transactions initiated before July 1, 2001.
- . Intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability.
- . Goodwill, as well as intangible assets with indefinite lives, acquired after June 30, 2001, will not be amortized.
- . Effective January 1, 2002, all previously recognized goodwill and intangible assets with indefinite lives will no longer be subject to amortization.
- . Effective January 1, 2002, goodwill and intangible assets with indefinite lives will be tested for impairment annually and whenever there is an impairment indicator.
- . All acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting.

On January 1, 2002, the Company adopted SFAS 142, and as required, discontinued amortization of goodwill and certain intangible assets determined to have indefinite useful lives acquired prior to July 1, 2001. This statement also required that within the first interim period of adoption, the intangible assets with indefinite lives should be tested for impairment as of the date of

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adoption, and that if any impairment results, it should be recognized as a change in accounting principle. Additionally, SFAS 142 requires that, within six months of adoption, goodwill be tested for impairment at the reporting unit level as of the date of adoption. If any impairment is indicated to have existed upon adoption, it should be measured and recorded before the end of the year of adoption. SFAS 142 requires that any goodwill impairment loss recognized as a result of initial application be reported in the first interim period of adoption as a change in accounting principle and that the income per share effects of the accounting change be separately disclosed. The Company has not yet determined the effect of these new impairment tests related to goodwill on its consolidated financial position or results of operations.

In August 2001, the FASB issued SFAS 143, Accounting for Asset Retirement Obligations. SFAS 143 applies to all entities, including rate-regulated entities, that have legal obligations associated with the retirement of a tangible long-lived asset that result from acquisition, construction or development and (or) normal operations of the long-lived asset. The application of this Statement is not limited to certain specialized industries, such as the extractive or nuclear industries. This Statement also applies, for example, to a company that operates a manufacturing facility and has a legal obligation to dismantle the manufacturing plant and restore the underlying land when it ceases operation of that plant. A liability for an asset retirement obligation should be recognized if the obligation meets the definition of a liability and can be reasonably estimated. The initial recording should be at fair value. SFAS 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002, with earlier application encouraged. The provisions of the Statement are not expected to have a material impact on the financial condition or results of operations of the Company.

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In August 2001, the FASB issued SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS 144 retains the existing requirements to recognize and measure the impairment of long-lived assets to be held and used or to be disposed of by sale. However, SFAS 144 makes changes to the scope and certain measurement requirements of existing accounting guidance. SFAS 144 also changes the requirements relating to reporting the effects of a disposal or discontinuation of a segment of a business. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. The adoption of this Statement did not have a significant impact on the financial condition or results of operations of the Company.

3. Change in Accounting Principle

Effective January 1, 2002, we adopted SFAS 142, "Goodwill and Other Intangible Assets." In connection with the adoption, we discontinued approximately \$886,000 in annual amortization of goodwill. SFAS 142 also requires companies to test intangibles for impairment on an annual basis. During the first quarter, the Company performed its first phase of testing under SFAS 142 pertaining to its evaluation of intangible assets determined to have indefinite useful lives, and determined that there was an impairment issue with certain trademarks relative to our security products segment. The fair values of the trademarks were determined using a royalty savings approach, discounted at appropriate risk-adjusted rates, which yielded results consistent with available market-approach data. The impairment of \$43,000, net of tax, was recorded as a cumulative effect of a change in accounting principle at March 31, 2002. The Company has not yet determined the financial impact, if any, that the impairment provisions of SFAS 142 as it pertains to goodwill will have on its consolidated financial statements. As provided under SFAS 142, the initial testing of

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goodwill for possible impairment will be completed within the first six months of 2002 and final testing, if possible impairment has been identified, by the end of the year.

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

	Three Months Ended March 31,	
	2002	2001
Net income, as reported	\$ 647	\$ 302
Add back: amortization expense, net of tax	-	\$ 139
Adjusted net income	\$ 647	\$ 441
Basic earnings per common share:		
As reported	\$ 0.03	\$ 0.01
Adjusted	\$ 0.03	\$ 0.02
Diluted earnings per common share:		
As reported	\$ 0.03	\$ 0.01
Adjusted	\$ 0.03	\$ 0.02

4. Other Intangible Assets

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

	March 31, 2002		
	Gross Carrying Amount	Accum. Amort.	
Amortized intangible assets:			
Deferred financing costs	\$ 359	\$ 112	\$
Non-amortized intangible assets:			
Trademarks - security products segment	\$ 1,835	\$ 1,270	\$
Service mark - car care segment	\$ 116	\$ 10	\$
Total non-amortized intangible assets	\$ 1,951	\$ 1,280	\$
Total intangible assets	\$ 2,310	\$ 1,392	\$

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

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

5. Business Combinations

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

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

6. Operating Agreement

The Company entered into a Management Agreement with Mark Sport, Inc. ("Mark Sport"), a Vermont corporation. Mark Sport is controlled by Jon E. Goodrich, a director of the Company. The Management Agreement entitled Mark Sport to operate the Company's Security Products Division and receive all profits or losses for a seven-month term beginning January 1, 2000. The Agreement was extended through April 30, 2002, as provided for in the original Management Agreement. In exchange, Mark Sport pays the Company \$20,000 per month through the term of the Management Agreement as extended. Additionally, Mark Sport must pay the Company an amount equal to the amortization and depreciation on the assets of the division at the end of the term of the Agreement. During the term of the Agreement, Mark Sport was required to operate the division in substantially the same manner as it has been operated prior to the Management Agreement. On April 30, 2002, the Management Agreement with Mark Sport expired. The Company is currently integrating the Security Products Division into the Company's operations and will begin reporting the financial results of this division during the second quarter of 2002.

7. Commitments and Contingencies

In December 1999, the Company was named as a defendant in a suit filed in the state of New York by Janeen Johnson et. al. The litigation concerns a claim that a self-defense spray manufactured by the Company and used by a law enforcement officer contributed to the suffering and death of Christopher Johnson. The Company forwarded the suit to its insurance carrier for defense. The Company does not anticipate that this claim will result in the payment of damages in excess of the Company's insurance coverage.

In October 2001, the Company was named as an additional party defendant in a suit filed by Alan Berndt and Martha Berndt in the United States District Court

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for the Northern District of California. The litigation alleges the Company was responsible for personal injuries arising out of Mr. Berndt's use of a Gas Launcher, which may have been manufactured or sold by the Company. We have forwarded the suit to our insurance carrier for defense. We do not anticipate that this claim will result in the payment of damages in excess of our insurance coverage.

Although the Company is not aware of any substantiated claim of permanent personal injury from its products, the Company is aware of reports of incidents in which, among other things, defense sprays have been mischievously or improperly used, in some cases by minors; have not been instantly effective; or have been ineffective against enraged or intoxicated individuals. Incidents of this type, or others, could give rise to product liability or other claims, or to claims that past or future advertising, packaging or other practices should be, or should have been, modified, or that regulation of products of this nature should be extended or changed.

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

Certain of the Company's executive officers have entered into employment agreements whereby they will be entitled to immediate vesting provisions of issued options should the officer be terminated upon a change in control of the Company. Additionally, the employment agreement of the Company's Chief Executive Officer, Louis D. Paolino, Jr., entitles Mr. Paolino to receive a fee of

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\$7,000,000 upon termination of employment under certain conditions including upon termination as a result of a change in control.

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

8. Business Segments Information

The Company currently operates in the Car Care segment, supplying complete car care services (including wash, detailing, lube, and minor repairs), fuel, and merchandise sales and receives revenues under a Management Agreement related to the Company's previously operated Security Products segment. The Company is currently being paid \$20,000 per month, which started in February 2000, under a Management Agreement which allows Mark Sport, Inc., an entity controlled by Jon E. Goodrich, a director of the Company, to operate the Company's Security Products Division.

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

Car Care	Security Products
-----	-----
(In Thousands)	

Three months ended March 31, 2002

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Revenues from external customers	\$	11,696	\$	6
Intersegment revenues		-		
Segment income (loss)	\$	652	\$	(
Segment assets	\$	100,827	\$	3,52
Three months ended March 31, 2001				
Revenues from external customers	\$	12,769	\$	6
Intersegment revenues		-		
Segment income	\$	264	\$	3

9. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. Such estimates include the Company's estimates of reserves such as the allowance for doubtful accounts receivable and inventory valuation allowances.

10. Income Taxes

The Company recorded a tax expense of \$388,000 for the three months ended March 31, 2002. Tax expense reflects the recording of income taxes at an effective rate of 36%. The effective rate differs from the federal statutory rate primarily due to state and local income taxes, non-deductible costs related to acquired intangibles, and the use of net operating loss carryforwards.

11. Earnings Per Share

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

	Three Months
	3/31/02
Numerator:	
Net income (in thousands).....	\$ 647
Denominator:	
Denominator for basic income	
per share - weighted average shares.....	25,386,754
Dilutive effect of options and warrants.....	50,009
Denominator for diluted income	
per share - weighted average shares.....	25,436,763
Basic income per share.....	\$ 0.03
Diluted income per share.....	\$ 0.03

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

Forward Looking Statements

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

Introduction

Revenues

Car Care Services

We own full service, exterior only and self-service car wash locations in New Jersey, Pennsylvania, Delaware, Texas, Florida and Arizona, as well as truck washes in Arizona, Indiana, Ohio and Texas. We earn revenues from washing and detailing automobiles; performing oil and lubrication services, minor auto repairs, and state inspections; selling fuel; and selling merchandise through convenience stores within the car wash facilities. Revenues generated for the three months ended March 31, 2002 for the car care segment were comprised of approximately 85% car wash and detailing, 9% lube and other automotive services, 6% fuel and merchandise.

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

Weather can have a significant impact on volume at the individual locations. However, we believe that the geographic diversity of our operating locations minimizes weather-related influence on our volume.

Security Products

The Company was paid \$20,000 per month under a Management Agreement which allowed Mark Sport, an entity controlled by Jon E. Goodrich, a director of the Company, to operate the Security Products segment. Total revenues under the Management Agreement were \$60,000 for the three months ending March 31, 2002.

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Cost of Revenues

Car Care Services

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

Selling, General and Administrative Expenses

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

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We capitalize direct incremental costs associated with purchase acquisitions. Indirect acquisition costs, such as executive salaries, corporate overhead, public relations, and other corporate services and overhead are expensed as incurred.

At March 31, 2002, capitalized costs related directly to proposed acquisitions that were not yet consummated were approximately \$10,000. We periodically review the future likelihood of these acquisitions and record appropriate provisions against capitalized costs associated with projects that are not likely to be completed.

Depreciation and Amortization

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

Other Income and Expense

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

Income Taxes

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

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

Three Months E

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	March 31,
	2002
Revenues	100.0%
Cost of revenues	67.3
Selling, general and administrative expenses	15.3
Depreciation and amortization	4.0
Operating income	13.4
Interest expense, net	(4.8)
Other income	0.6
Income before income taxes	9.2
Income tax expense	3.3
Income before cumulative effect of a change in accounting principle	5.9
Cumulative effect of a change in accounting principle, net of tax	0.4
Net income	5.5%

Liquidity and Capital Resources

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

As of March 31, 2002, we had working capital of approximately \$1.3 million and cash and cash equivalents of \$6.9 million. Working capital was \$4.8 million at December 31, 2001. The decrease in working capital at March 31, 2002 is primarily attributable to the reclass of approximately \$4.7 million of 15 year amortizing loans from long term to current liabilities as a result of such loans being due in February 2003. The Company intends to renew these loans with the current lender. For the three months ended March 31, 2002, net cash provided by operations was

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approximately \$1.1 million, net cash used in financing activities was approximately \$635,000 and net cash used in investing activities was approximately \$143,000 resulting in an increase in cash and cash equivalents for the quarter of approximately \$331,000. Capital expended during the period included approximately \$133,000 for the purchase of operating equipment.

We estimate aggregate capital expenditures, exclusive of acquisitions of businesses, of approximately \$500,000 for the remainder of the year ending December 31, 2002.

At March 31, 2002, we had borrowings of approximately \$33.8 million. We had two letters of credit outstanding at March 31, 2002, totaling \$625,000 as collateral relating to worker compensation insurance policies. We do not have a revolving credit facility.

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During 2001, we refinanced on a long term basis under favorable terms the majority of our short term debt related to our 1999 and 2000 acquisitions. We also had various other long term mortgage notes up for periodic review during 2001 which we have been successful in renewing. Several of our debt agreements, as amended, contain certain affirmative and negative covenants and require the maintenance of certain levels of tangible net worth and the maintenance of certain debt coverage ratios on an individual subsidiary and consolidated level.

On April 5, 2000, we executed a master facility agreement with Fusion Capital Fund II, LLC ("Fusion") pursuant to which Fusion agreed to enter into up to two equity purchase agreements, each with an aggregate principal amount of \$12.0 million. The equity purchase agreements allow us to suspend the purchasing of our common stock by Fusion if the price of our common stock is less than \$7.00 per share. We are currently not permitting the purchase of our common stock under the equity purchase agreement due to the current low trading value of our common stock and the potentially dilutive effect of such stock purchases. If and when we agree to the purchase of our stock, Fusion has the right to purchase from us shares of common stock up to \$12.0 million at a price equal to the lesser of (1) 140% of the average of the closing bid prices for our common stock during the 10 trading days prior to the date of the applicable equity purchase agreement or \$7.00, whichever is greater or (2) a price based upon the future performance of the common stock, in each case without any fixed discount to the market price. As long as we have not suspended Fusion from purchasing our stock, the equity purchase agreement requires that at the beginning of each month, Fusion will pay us \$1.0 million as partial prepayment for the common stock. Once the \$1.0 million has been applied to purchase shares of our common stock, Fusion will pay the remaining principal amount upon receipt of our common stock. The first equity purchase agreement was executed by Fusion on April 17, 2000. Proceeds from purchased shares through December 31, 2001 totaled approximately \$1.3 million. The first equity purchase agreement was extended to February 20, 2003. The second equity purchase agreement will be executed after delivery of an irrevocable written notice by us to Fusion stating that we elect to enter into such purchase agreement with Fusion. The second equity purchase agreement may be entered into only after the principal amount under the first equity purchase agreement is fully converted into our common stock.

Seasonality and Inflation

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

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

Results of Operations for the Three Months Ended March 31, 2002 Compared to the Three Months Ended March 31, 2001

Revenues

Car Care Services

Revenues for the three months ended March 31, 2002 were \$11.7 million as compared to \$12.8 million for the three months ended March 31, 2001, a decrease of \$1.1 million or 8.4%. Of the \$1.1 million decrease, approximately \$648,000 was from wash and detail services, \$171,000 was from lube and other automotive services, \$254,000 was from fuel and merchandise sales. Of the \$11.7 million of revenues for the three months ended March 31, 2002, \$10.0 million or 85% was generated from car wash and detailing, \$1.0 million or 9% from lube and other automotive services, and \$700,000 or 6% from fuel and merchandise sales. Of the

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\$12.8 million of revenues for the three months ended March 31, 2001, \$10.6 million or 83% was generated from car wash

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and detailing, \$1.2 million or 9% from lube and other automotive services, and \$1.0 million or 8% from fuel and merchandise sales. The decrease in wash and detailing revenues was principally due to the divesting of two of our car wash locations during 2001 combined with a departure from our historic revenue levels within our Northeast region due to the unusual lack of snow in 2002. This decline in revenues was partially offset by internal growth through a continued aggressive focus on selling detailing and additional on-line car wash services which increased the average wash and detailing revenues per car by 2.8% or \$.37 to \$13.71 in 2002, from \$13.34 per car in the first quarter of 2001. As to the decline in lube and other automotive services, we discontinued the practice of providing a free wash to lube customers resulting in decreased lube revenues but improved overall site gross margin performance. The decline in fuel and merchandise gross revenues is the result of instituting certain minimum sale margin criteria which reduced gross fuel sales and the sale of certain low margin merchandise.

Security Products

During the three months ended March 31, 2002 and 2001, pursuant to a Management Agreement, the Company was paid \$60,000. This amount is included under revenues from operating agreements.

Cost of Revenues

Car Care Services

Cost of revenues for the three months ended March 31, 2002 were \$7.9 million or 68% of revenues with car washing and detailing costs at 65% of respective revenues, lube and other automotive services costs at 76% of respective revenues, and fuel and merchandise costs at 86% of respective revenues. Cost of revenues for the three months ended March 31, 2001 were \$9.1 million, or 71% of revenues. With our increase in average wash and detailing revenues per car in 2002 and our continued emphasis on controlling direct labor and other operating costs such as wash and detailing chemicals and supplies, car damages, uniform expense, and repairs and maintenance costs, we achieved improved wash and detailing gross margins in 2002. We reduced our direct labor costs as a percent of wash and detail revenues to 44.9% in 2002 as compared to 46.3% in the first three months of 2001.

Security Products

During the first quarter of 2002 and 2001, pursuant to a Management Agreement, no costs were incurred by us.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the three months ended March 31, 2002 were \$1.79 million compared to \$1.84 million for the same period in 2001, a decrease of approximately \$45,000 or 2%. SG&A costs as a percent of revenues were 15.3% for the three months ended March 31, 2002 as compared to 14.3% in the first quarter of 2001. The decrease in SG&A costs is primarily the result of a decrease in administrative salaries and certain office costs partially offset by an increase in insurance costs and business taxes.

Depreciation and Amortization

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Depreciation and amortization totaled \$472,000 for the three months ended March 31, 2002 as compared to \$675,000 for the same period in 2001. This decrease is primarily attributable to the adoption of SFAS 142 on January 1, 2002, under which the Company no longer amortizes goodwill and other intangible assets determined to have indefinite useful lives.

Interest Expense, Net

Interest expense, net of interest income, for the three months ended March 31, 2002, was \$563,000 compared to \$819,000 for the three months ended March 31, 2001. This decrease in our interest expense is the result of a decrease in interest rates on approximately 50% of our long term debt which has interest rates tied to the prime rate and a reduction in our outstanding debt as a result of normal principal payments.

Other Income and Expense

Other income for the three months ended March 31, 2002 was \$66,000 compared to \$63,000 for the three months ended March 31, 2001.

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Income Taxes

We recorded a tax expense of \$388,000 for the three months ended March 31, 2002. Tax expense reflects the recording of income taxes at an effective rate of 36%. The effective rate differs from the federal statutory rate primarily due to state and local income taxes, non-deductible costs related to acquired intangibles, and the use of net operating loss carryforwards.

Risk Factors

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

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

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

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

Listing on the Nasdaq National Market. If our common stock does not maintain a minimum bid price of one dollar for thirty consecutive days, we are subject to being delisted from the Nasdaq National Market. If our stock is under \$1.00 for thirty consecutive business days, we will be able to maintain our listing if during the next 90 day period, our stock maintains at least a minimum bid price of \$1.00 for a ten consecutive day period. The ten day period required can be extended at the discretion of Nasdaq. Upon delisting from the Nasdaq National Market, our stock would be traded on the Nasdaq SmallCap Market until we maintain a minimum bid price of one dollar for thirty consecutive days at which time we can regain listing on the Nasdaq National Market. If our stock does not maintain a minimum bid price of one dollar for thirty consecutive days during a 180 day grace period on the Nasdaq SmallCap Market or a 360 day grace period if compliance with certain core listing standards are demonstrated, we will receive a delisting notice from the Nasdaq SmallCap Market. Upon delisting from the Nasdaq SmallCap Market, our stock may be traded over-the-counter, more commonly known as OTC. OTC transactions involve risks in addition to those associated with transactions in securities traded on the Nasdaq National Market or the Nasdaq SmallCap Market (together "Nasdaq-Listed Stocks"). OTC companies may have limited product lines, markets or financial resources. Many OTC stocks trade less frequently and in smaller volumes than Nasdaq-Listed Stocks. The values of these stocks may be more volatile than Nasdaq-Listed Stocks. If our stock is traded in the OTC market and a market maker sponsors us, we may have the price of our stock electronically displayed on the OTC Bulletin Board, or OTCBB. However, if we lack sufficient market maker support for display on the OTCBB, we must have our price published by the National Quotations Bureau LLP in a paper publication known as the "Pink Sheets." The marketability of our stock will be even more limited if our price must be published on the "Pink Sheets."

We have reported net losses in the past. We have reported net losses and working capital deficits in the past, and we have expended substantial funds for acquisitions and equipment. In connection with financing acquisitions and business growth, we anticipate that we will continue to incur significant debt and interest charges. Several of our debt agreements, as amended, contain certain affirmative and negative covenants and require the maintenance of certain levels of tangible net worth and the maintenance of certain debt coverage ratios on an individual subsidiary and consolidated level. If our results are not sufficient to maintain the required ratios, we would be in default of our loan agreements. With the adoption of SFAS 142 on January 1, 2002, we no longer amortize goodwill and certain intangible assets determined to have indefinite useful lives. Additionally, SFAS 142 requires annual fair value based impairment tests of goodwill and other intangible assets identified with indefinite useful lives. Although we have not yet determined the full effect of these new impairment tests, future charges to our consolidated statement of operations could result should impairment losses be identified.

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Our business plan poses risks for us. One of our business objectives is to develop as a full service, integrated car care business through acquisitions and through the internal development of our car wash facilities. We have repositioned our company from one involved primarily in the production of consumer defense products to a company that provides car wash and car care services. This strategy involves a number of risks, including:

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

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

We have a limited operating history regarding our car and truck wash businesses. Since July 1999, our main business has been the acquisition and operation of car wash facilities, which now accounts for substantially all of our revenues. Because of our relatively limited operating history with respect to this business, we cannot assure you that we will be able to operate it successfully.

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

Our car wash business may suffer under certain weather conditions. Seasonal trends in some periods may affect our car wash business. In particular, long periods of rain and cloudy weather can adversely affect our car wash business as people typically do not wash their cars during such periods. Additionally, extended periods of warm, dry weather may encourage customers to wash their cars themselves which also can adversely affect our car wash business.

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

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

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

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

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claims.

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

We must maintain our car wash equipment. Although we undertake to keep our car washing equipment in proper operating condition, the operating environment found in car washes results in frequent mechanical problems. If we fail to properly maintain the equipment, the car wash could become inoperable resulting in a loss of revenue.

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Our car wash and car care services operations face governmental regulations. We are governed by federal, state and local laws and regulations, including environmental regulations, that regulate the operation of our car wash centers and other car care services businesses. Car wash centers utilize cleaning agents and waxes in the washing process that are then discharged in waste water along with oils and fluids washed off of vehicles. Other car care services, such as gasoline and lubrication, use a number of oil derivatives and other regulated hazardous substances. As a result, we are governed by environmental laws and regulations dealing with, among other things:

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

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

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

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

Our preferred stock may affect the rights of the holders of our common stock; it may also discourage another entity from acquiring control of Mace. Our Certificate of Incorporation authorizes the issuance of up to 10,000,000 shares

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of preferred stock. No shares of preferred stock are currently outstanding. It is not possible to state the precise effect of preferred stock upon the rights of the holders of our common stock until the Board of Directors determines the respective preferences, limitations and relative rights of the holders of one or more series or classes of the preferred stock. However, such effect might include: (i) reduction of the amount otherwise available for payment of dividends on common stock, to the extent dividends are payable on any issued shares of preferred stock, and restrictions on dividends on common stock if dividends on the preferred stock are in arrears, (ii) dilution of the voting power of the common stock to the extent that the preferred stock has voting rights, and (iii) the holders of common stock not being entitled to share in our assets upon liquidation until satisfaction of any liquidation preference granted to the preferred stock.

The preferred stock may be viewed as having the effect of discouraging an unsolicited attempt by another entity to acquire control of us and may therefore have an anti-takeover effect. Issuances of authorized preferred stock can be implemented, and have been implemented by some companies in recent years with voting or conversion privileges intended to make an acquisition of the company more difficult or costly. Such an issuance could discourage or limit the stockholders' participation in certain types of transactions that might be proposed (such as a tender offer), whether or not such transactions were favored by the majority of the stockholders, and could enhance the ability of officers and directors to retain their positions.

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

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

There are additional risks set forth in the incorporated documents. In addition to the risk factors set forth above, you should review the financial statements and exhibits incorporated into this report. Such documents may contain, in certain

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instances and from time to time, additional and supplemental information relating to the risks set forth above and/or additional risks to be considered by you, including, without limitation, information relating to losses experienced by us in certain historical periods, working capital deficits at particular dates, information relating to pending and recently completed acquisitions, descriptions of new or changed federal or state regulations applicable to Mace, data relating to remediation and the actions taken by Mace, and estimates at various times of Mace's potential liabilities for compliance with environmental laws or in connection with pending litigation.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in our exposure to market risks arising from fluctuations in foreign currency exchange rates, commodity prices, equity prices

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or market interest rates since December 31, 2001 as reported by our Form 10-K for the year ended December 31, 2001.

PART II OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

None.

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

None.

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SIGNATURES

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

Mace Security International, Inc.

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

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

BY: /s/ Gregory M. Krzemien

Gregory M. Krzemien, Chief Financial Officer

BY: /s/ Ronald R. Pirollo

Ronald R. Pirollo, Controller (Principal Accounting
Officer)

DATE: May 10, 2002

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