

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

MACE SECURITY INTERNATIONAL INC  
Form 10-Q  
November 12, 2003

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 SEPTEMBER 30, 2003

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

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

As of November 6, 2003, there were 12,415,192 Shares of Registrant's Common Stock, par value \$.01 per share, outstanding.

Mace Security International, Inc.  
Form 10-Q  
Quarter Ended September 30, 2003

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### PART I FINANCIAL INFORMATION

#### Item 1. Financial Statements

Mace Security International, Inc.  
Consolidated Balance Sheets

(In thousands except share information)

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| ASSETS  | September 30,<br>2003 |             |
|---|-----------------------|-------------|
|   | -----                 | (Unaudited) |
| Current assets:   |                       |             |
| Cash and cash equivalents   | \$                    | 3,940       |
| Accounts receivable, less allowance for doubtful<br>accounts of \$288 and \$198 in 2003 and 2002, respectively    |                       | 1,391       |
| Inventories   |                       | 3,776       |
| Deferred income taxes   |                       | 230         |
| Prepaid expenses and other current assets   |                       | 2,144       |
|   |                       | -----       |
| Total current assets  |                       | 11,481      |
| Property and equipment:   |                       |             |
| Land  |                       | 31,804      |
| Buildings and leasehold improvements  |                       | 35,274      |
| Machinery and equipment   |                       | 9,893       |
| Furniture and fixtures  |                       | 447         |
|   |                       | -----       |
| Total property and equipment  |                       | 77,418      |
| Accumulated depreciation and amortization   |                       | (10,373)    |
|   |                       | -----       |
| Total property and equipment, net of accumulated depreciation<br>and amortization                                 |                       | 67,045      |
| Goodwill  |                       | 13,390      |
| Other intangible assets, net of accumulated amortization<br>of \$1,454 and \$1,415 in 2003 and 2002, respectively |                       | 974         |
| Deferred income taxes   |                       | 1,669       |
| Other assets  |                       | 179         |
|   |                       | -----       |
| Total assets  | \$                    | 94,738      |
|   |                       | =====       |

See accompanying notes.

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| LIABILITIES AND STOCKHOLDERS' EQUITY                           | September 30,<br>2003 |        | Dece  |
|--|-----------------------|--------|-------|
|  | -----                 |        | ----- |
|  | (Unaudited)           |        |       |
| Current liabilities:   |                       |        |       |
| Current portion of longterm debt and capital lease obligations | \$                    | 10,660 | \$    |
| Accounts payable   |                       | 2,173  |       |
| Income taxes payable   |                       | 89     |       |

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|  |           |       |
|--|-----------|-------|
| Deferred revenue   | 266       |       |
| Accrued expenses and other current liabilities   | 2,931     |       |
|  |           | ----- |
| Total current liabilities  | 16,119    |       |
| Longterm debt, net of current portion  | 20,599    |       |
| Capital lease obligations, net of current portion  | 217       |       |
| Other liabilities  | 38        |       |
| 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 12,415,192 and<br>12,407,655 in 2003 and 2002, respectively | 124       |       |
| Additional paidin capital  | 69,734    |       |
| Accumulated deficit  | (12,093)  |       |
|  |           | ----- |
| Total stockholders' equity   | 57,765    |       |
|  |           | ----- |
| Total liabilities and stockholders' equity   | \$ 94,738 | \$    |
|  |           | ===== |

See accompanying notes.

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

(In thousands except share information)

|                                    |    |          |
|------------------------------------|----|----------|
|                                    |    | Three Mo |
|                                    |    | Septe    |
|                                    |    | 2003     |
|                                    |    | -----    |
| Revenues:                          |    |          |
| Car wash and detailing services    | \$ | 8,276    |
| Lube and other automotive services |    | 1,089    |
| Fuel and merchandise sales         |    | 925      |
| Security products sales            |    | 1,586    |
|                                    |    | -----    |
|                                    |    | 11,876   |

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Cost of revenues:

|  |            |
|--|------------|
| Car wash and detailing services                | 6,396      |
| Lube and other automotive services             | 815        |
| Fuel and merchandise sales                     | 823        |
| Security products sales                        | 914        |
|  | -----      |
|  | 8,948      |
| <br>   |            |
| Selling, general and administrative expenses   | 2,325      |
| Depreciation and amortization                  | 487        |
| Costs of terminated acquisitions               | -          |
|  | -----      |
| Operating income                               | 116        |
| <br>   |            |
| Interest expense, net                          | (443)      |
| Other income                                   | 43         |
|  | -----      |
| Loss before income taxes                       | (284)      |
| <br>   |            |
| Income tax benefit                             | (102)      |
|  | -----      |
| Net loss                                       | \$ (182)   |
|  | =====      |
| <br>   |            |
| Per share of common stock (basic and diluted): |            |
| Net loss                                       | \$ (0.01)  |
|  | =====      |
| <br>   |            |
| Weighted average shares outstanding:           |            |
| Basic  | 12,412,189 |
| Diluted  | 12,412,189 |

See accompanying notes.

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

(In thousands except share information)

|                                    | Nine Mo<br>Septe<br>2003 |
|------------------------------------|--------------------------|
|                                    | -----                    |
| Revenues:                          |                          |
| Car wash and detailing services    | \$ 27,080                |
| Lube and other automotive services | 3,133                    |
| Fuel and merchandise sales         | 2,723                    |
| Security products sales            | 3,843                    |
| Operating agreement                | -                        |

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|   |       |            |
|---|-------|------------|
|   | ----- |            |
|   |       | 36,779     |
| Cost of revenues:   |       |            |
| Car wash and detailing services   |       | 19,806     |
| Lube and other automotive services  |       | 2,402      |
| Fuel and merchandise sales  |       | 2,387      |
| Security products sales   |       | 2,214      |
|   | ----- |            |
|   |       | 26,809     |
| Selling, general and administrative expenses  |       | 6,777      |
| Depreciation and amortization   |       | 1,462      |
| Asset impairment charge   |       | 351        |
| Costs of terminated acquisitions  |       | -          |
|   | ----- |            |
| Operating income  |       | 1,380      |
| Interest expense, net   |       | (1,476)    |
| Other income  |       | 210        |
|   | ----- |            |
| Income before income taxes  |       | 114        |
| Income tax expense  |       | 42         |
|   | ----- |            |
| Income before cumulative effect of a change in accounting principle                     |       | 72         |
| Cumulative effect of a change in accounting principle,<br>net of tax benefit of \$2,188 |       | -          |
|   | ----- |            |
| Net income (loss)   | \$    | 72         |
|   | ===== |            |
| Per share of common stock (basic and diluted):  |       |            |
| Income before cumulative effect of a change in accounting principle                     | \$    | 0.01       |
| Cumulative effect of a change in accounting principle, net of tax                       |       | -          |
|   | ----- |            |
| Net income (loss)   | \$    | 0.01       |
|   | ===== |            |
| Weighted average shares outstanding:  |       |            |
| Basic   |       | 12,409,747 |
| Diluted   |       | 12,422,952 |

See accompanying notes.

Mace Security International, Inc.  
Consolidated Statement of Stockholders' Equity  
(Unaudited)

(In thousands except share information)

Number of                      Par Value                      Additional

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|   | Common<br>Shares<br>-----    | of Common<br>Stock<br>----- | Paid in<br>Capital<br>----- | Accumulat<br>Deficit<br>----- |
|---|------------------------------|-----------------------------|-----------------------------|-------------------------------|
| Balance at December 31, 2002.....                   | 12,407,655                   | \$ 124                      | \$ 69,710                   | \$ (12,                       |
| Shares purchased and retired.....                   | (12,200)                     | -                           | (14)                        |                               |
| Common stock issued in purchase<br>acquisition..... | 19,737                       | -                           | 38                          |                               |
| Net income.....                                     |                              |                             |                             |                               |
| Balance at September 30, 2003....                   | -----<br>12,415,192<br>===== | \$ 124<br>-----<br>=====    | \$ 69,734<br>-----<br>===== | \$ (12,<br>-----<br>=====     |

See accompanying notes.

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

(In thousands)

|   | Nine Mon<br>Septem<br>2003<br>----- |
|---|-------------------------------------|
| Operating activities  |                                     |
| Income before cumulative effect of a change in accounting principle                         | \$ 72                               |
| Cumulative effect of a change in accounting principle,<br>net of tax benefit                | -----<br>-                          |
| Net income (loss)   | 72                                  |
| Adjustments to reconcile net income (loss) to net cash provided by operating<br>activities: |                                     |
| Depreciation and amortization   | 1,462                               |
| Provision for losses on receivables   | 53                                  |
| Cumulative effect of change in accounting principle   |                                     |
| Asset impairment charge   | 351                                 |
| Deferred income taxes   | 32                                  |
| Loss on disposal of fixed assets  | 3                                   |
| Changes in operating assets and liabilities:  |                                     |
| Accounts receivable   | (673)                               |
| Inventories   | (1,101)                             |
| Accounts payable  | (425)                               |
| Deferred revenue  | (113)                               |
| Accrued expenses  | 887                                 |

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|  |          |
|--|----------|
| Income taxes   | (121)    |
| Prepaid expenses and other assets                        | (101)    |
|  | -----    |
| Net cash provided by operating activities                | 326      |
| Investing activities                                     |          |
| Purchase of property and equipment                       | (712)    |
| Acquisition of business, net of cash acquired            |          |
| Payments for intangibles                                 | (14)     |
|  | -----    |
| Net cash used in investing activities                    | (726)    |
| Financing activities                                     |          |
| Payments on long term debt and capital lease obligations | (1,835)  |
| Payments to purchase stock                               | (14)     |
|  | -----    |
| Net cash used in financing activities                    | (1,849)  |
|  | -----    |
| Net (decrease) increase in cash and cash equivalents     | (2,249)  |
| Cash and cash equivalents at beginning of period         | 6,189    |
|  | -----    |
| Cash and cash equivalents at end of period               | \$ 3,940 |
|  | =====    |

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" 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 nine month period ended September 30, 2003 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, 2002.

On December 17, 2002, we effected a one-for-two reverse stock split. All stock prices, share amounts, per share information, stock options and warrants have been retroactively restated to reflect the reverse split, unless otherwise noted.

#### 2. New Accounting Standards

In June 2002, the Financial Accounting Standards Board ("FASB") approved the



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issuance of Statement of Financial Accounting Standards ("SFAS") 146, Accounting for Exit or Disposal Activities. SFAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that were previously accounted for pursuant to the guidance that the Emerging Issues Task Force "EITF" had set forth in EITF Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The adoption of SFAS 146 did not have a material effect on the Company's financial position or results of operations.

In December 2002, the FASB issued SFAS 148, Accounting for Stock-Based Compensation - Transition and Disclosure. SFAS 148 amends SFAS 123 Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS 148 is effective for fiscal years beginning after December 15, 2002. The expanded annual disclosure requirements and the transition provisions are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The adoption of SFAS 148 did not have a material effect on the Company's financial position or results of operations.

In November 2002, FASB Interpretation 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45), was issued. FIN 45 requires a guarantor entity, at the inception of a guarantee covered by the measurement provisions of the interpretation, to record a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN 45 applies prospectively to guarantees the Company issues or modifies subsequent to December 31, 2002, but has certain disclosure requirements effective for interim and annual periods ending after December 15, 2002. The Company has not historically issued guarantees and does not anticipate FIN 45 will have a material effect on its 2003 consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation 46 (FIN 46), Consolidation of Variable Interest Entities. FIN 46 clarifies the application of Accounting Research Bulletin 51, Consolidated Financial Statements, for certain entities that do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties or in which equity investors do not have the characteristics of a controlling financial interest ("variable interest entities"). Variable interest entities within the scope of FIN 46 will be required to be consolidated by their primary beneficiary. The primary beneficiary of a variable interest entity is determined to be the party that absorbs a majority of the entity's expected losses, receives a majority of its expected returns, or both. FIN 46 applies immediately to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The adoption of FIN 46 did not have a material effect on the Company's consolidated financial position, results of operations, or cash flows.

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In May 2003, the FASB issued SFAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS 150 established standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS 150 requires that issuers classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). SFAS 150 is effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this statement did not have a material impact on the Company's consolidated financial position or results of operations.

### 3. Change in Accounting Principle

Effective January 1, 2002, we adopted SFAS 142, Goodwill and Other Intangible Assets. SFAS 142 requires companies to test intangibles for impairment on an annual basis. During 2002, the Company performed its testing under SFAS 142 pertaining to its evaluation of intangible assets determined to have indefinite useful lives, and determined that there were impairment issues with goodwill and certain trademarks used in our Security Products Segment.

The fair values of the trademarks were determined using a royalty savings approach, discounted at appropriate risk-adjusted rates, which yielded results consistent with available market-approach data. The impairment of \$43,000, net of tax, was recorded as a cumulative effect of a change in accounting principle at March 31, 2002.

Under the provisions of SFAS 142, the Company was also required to complete a goodwill impairment test. The first step of the transitional testing was the determination of our reporting units and the estimation of the fair values of the reporting units. A discounted cash flow model was used to estimate the fair value of our reporting units. The Company engaged an independent appraisal firm to determine appropriate discount rates for each reporting unit. Discount rates were derived by using the weighted average cost of capital technique. The discount rates were then used by the Company in the discounted cash flow calculations. Significant estimates and assumptions were used in assessing the fair value of the reporting units. These estimates and assumptions involved future cash flows, growth rates, discount rates, weighted average cost of capital and estimates of market valuations of each of the reporting units. In the third quarter of 2002, as a result of the goodwill impairment testing for our Car and Truck Wash Segment, we determined that the book value of our Northeast reporting unit exceeded its current fair value by \$1.84 million. The Northeast reporting unit's fair value was based on expectations for the business in light of the current economic environment and the uncertainty associated with recent volume due to unfavorable weather patterns. Additionally, there was an impairment of \$5.34 million in our Arizona reporting unit due to unfavorable economic conditions combined with a significant increase in local competition. This charge represented a complete write-off of the goodwill associated with this reporting unit. Finally, there was an impairment loss of \$670,000 in our truck wash reporting unit, primarily because we did not acquire additional truck washes necessary to achieve the scale needed to attract national accounts. This charge represented a complete write-off of the goodwill associated with this reporting unit. The results for the six months ended June 30, 2002 were restated to reflect the cumulative effect of a change in accounting principle in accordance with SFAS 142.

We will perform our annual testing of goodwill and intangible assets determined to have indefinite lives in accordance with SFAS 142 as of November 30, each year, or whenever there is an impairment indicator. The Company cannot guarantee that there will not be impairments in this or subsequent years.

## 4. Other Intangible Assets

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

|   | September 30, 2003       |                             |                             |
|---|--------------------------|-----------------------------|-----------------------------|
|   | Gross Carrying<br>Amount | Accumulated<br>Amortization | Gross<br>Carrying<br>Amount |
| Amortized intangible assets:            |                          |                             |                             |
| Non compete agreement                   | \$ 28                    | \$ 6                        | \$                          |
| Customer list                           | 69                       | 17                          |                             |
| Deferred financing costs                | 380                      | 151                         |                             |
| Total amortized intangible assets       | 477                      | 174                         |                             |
| Non amortized intangible assets:        |                          |                             |                             |
| Trademarks Security Products Segment    | 1,835                    | 1,270                       |                             |
| Service mark Car and Truck Wash Segment | 116                      | 10                          |                             |
| Total non amortized intangible assets   | 1,951                    | 1,280                       |                             |
| Total intangible assets                 | \$ 2,428                 | \$ 1,454                    | \$                          |

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

|      |      |
|------|------|
| 2003 | \$53 |
| 2004 | 47   |
| 2005 | 43   |
| 2006 | 26   |
| 2007 | 23   |

## 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; 11 facilities were subsequently divested or closed. The five full service truck wash facilities are located in Arizona, Indiana, Ohio and Texas.

On August 12, 2002, the Company acquired the inventory, certain other assets and the operations of Micro-Tech Manufacturing, Inc. ("Micro-Tech"), a manufacturer and retailer of electronic security devices. Total consideration under the agreement was approximately \$505,000. At closing, the Company paid \$217,000 cash

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for inventory, \$15,625 cash representing the first of twelve equal monthly installments totaling \$187,500, and 13,158 (pre-reverse split) registered shares of common stock of the Company representing the first of eight quarterly payments of shares totaling 105,263 (pre-reverse split) shares. This transaction was accounted for using the purchase method of accounting in accordance with SFAS 141, Business Combinations.

On September 26, 2003, a wholly owned subsidiary within the Company's Security Products Segment acquired the inventory, certain other assets and the operations of Vernex, Inc., a manufacturer and retailer of electronic security monitors. Total consideration under the agreement was \$213,000 cash for inventory. The agreement also provides for additional cash consideration based on sales performance for a twelve month period subsequent to closing. This transaction was accounted for using the purchase method of accounting in accordance with SFAS 141, Business Combinations.

### 6. Stock Based Compensation

The Company accounts for stock options under SFAS 123, Accounting for Stock-Based Compensation, as amended by SFAS 148, which contains a fair value-based method for valuing stock-based compensation that entities may use, which measures compensation cost at the grant date based on the fair value of the award. Compensation is then recognized over the service period, which is usually the vesting period. Alternatively, SFAS 123 permits entities to continue accounting for employee stock options and similar equity instruments under Accounting Principles Board (APB) Opinion 25, Accounting for Stock Issued to Employees. Entities that continue to account for stock options using APB Opinion 25 are required to make pro forma disclosures of net income and earnings per share, as if the fair value-based method of accounting defined in SFAS 123 had been applied.

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At September 30, 2003, the Company had two stock based employee compensation plans. The Company accounts for the plans under the recognition and measurement principles of APB 25, Accounting for Stock Issued to Employees, and related interpretations. Stock-based employee compensation costs are not reflected in net (loss) income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net (loss) income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123, to stock-based employee compensation (in thousands, except per share amounts):

|  | Three Months Ended<br>September 30, |          | Ni   |
|--|-------------------------------------|----------|------|
|  | 2003                                | 2002     | 2003 |
| Net (loss) income, as reported   | \$ (182)                            | \$ (116) | \$   |
| Less: Stock based compensation costs under fair<br>value based method for all awards | (151)                               | (171)    |      |
| Pro forma net (loss) income  | \$ (333)                            | \$ (287) | \$   |

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|                               | ===== | =====  | ===== | =====     |
|-------------------------------|-------|--------|-------|-----------|
| Earnings per share    basic   |       |        |       |           |
| As reported                   | \$    | (0.01) | \$    | (0.01) \$ |
| Pro forma                     | \$    | (0.03) | \$    | (0.02) \$ |
| Earnings per share    diluted |       |        |       |           |
| As reported                   | \$    | (0.01) | \$    | (0.01) \$ |
| Pro forma                     | \$    | (0.03) | \$    | (0.02) \$ |

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 2002: expected volatility of 61%; risk-free interest rates ranging from 3.72% to 5.39%; and expected lives of 10 years. In the quarter ended September 30, 2003, 616,000 options were granted with an expected volatility of 22%, risk-free interest rates ranging from 3.74% to 4.45%; and expected life of 10 years. For the nine months ended September 30, 2003, a total of 676,000 options were granted with a weighted-average risk-free interest rate of 3.77%.

### 7. Operating Agreement

The Company has been directly operating its Security Products Segment since May 1, 2002. Previous to May 1, 2002, the Security Products Segment was operated by Mark Sport, Inc. ("Mark Sport") under a management agreement which expired on April 30, 2002 (the "Management Agreement"). Mark Sport is controlled by Jon E. Goodrich, a Director of the Company. Under the Management Agreement, beginning on January 1, 2000, Mark Sport operated the segment and received all profits and losses therefrom. In exchange, Mark Sport paid the Company a monthly fee of \$20,000 and, upon termination of the agreement, an amount equal to the amortization and depreciation of the assets of the division.

### 8. Commitments and Contingencies

In December 1999, the Company was named as a defendant in a suit filed in the Supreme Court of 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 2000, the Company was named as a defendant in a suit filed in the United States District Court for the District of Colorado by Robert Rifkin. The suit alleges that the Company and its transfer agent delayed in the removal of a restrictive legend from certain shares of Company common stock owned by the plaintiff, and that the delay caused the plaintiff to incur a loss in excess of \$335,000. Though the outcome of litigation is always uncertain, the Company believes that there was no delay in the removal of the legend from the shares.

In July 2001, the Company filed a lawsuit in the Supreme Court of New York County of the State of New York against LTV Networks, Inc., ("LTV") to collect upon a promissory note in the amount of \$100,000. In January 2002, defendant LTV filed an answer to the suit denying liability under the promissory note and making counterclaims. The counterclaims allege that the Company had agreed to lend LTV \$500,000 and that LTV has been damaged in the amount of \$10 million because the Company only lent \$100,000 to LTV. The Company has filed a summary judgement motion which requests a judgement on the promissory note and a dismissal of the defendant's counterclaims. On August 29, 2003, LTV filed a Voluntary Petition for Chapter 11 Reorganization in the United States Bankruptcy Court, Southern District of New York (the "Petition"). The Petition has the effect of operating as a stay on the State Court proceedings. Though the outcome

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of litigation is always uncertain, the Company currently believes that the counterclaims are without merit and intends to assert its claims in the Bankruptcy proceedings.

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

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

In July 2002, the Company and its former president, Jon Goodrich, were named as defendants in a lawsuit in the Supreme Court of New York County of the State of New York filed by Armor Holdings, et al. The suit alleges that the Company and Mr. Goodrich had violated the non-compete terms of various agreements entered into in April 1998, which transferred certain of the Company's then lines of business to the plaintiffs. The suit also alleges that the Company violated a right of first refusal on sale granted to plaintiffs, when the Company entered into a Management Agreement with Mark Sport, Inc., to operate the Company's Consumer Products Division. The lawsuit requests \$15 million in damages. Though the outcome of litigation is always uncertain, the Company believes that all of the claims are without merit.

The Company has received a subpoena in connection with an investigation being conducted by the Securities and Exchange Commission of possible securities law violations. The subpoena was issued on October 27, 2003. The subpoena generally requests documents and information which would identify persons who knew of two transactions involving the Company prior to Mace's public announcement of the transactions. The transactions were announced by Mace on March 29, 1999 and were consummated in July of 1999. The subpoena also requests documents relating to Mace's dealings with two investment banking firms and certain of their employees. Mace intends to fully cooperate with the Securities and Exchange Commission's investigation.

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

Although the Company is not aware of any substantiated claim of permanent personal injury from its products, the Company is aware of reports of incidents in which, among other things, defense sprays have been mischievously or improperly used, in some cases by minors; have not been instantly effective; or have been ineffective against enraged or intoxicated individuals.

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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 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.

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### 9. 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 Products Segment. From January 1, 2000 through April 30, 2002, the Company was paid \$20,000 per month under a Management Agreement pursuant to which Mark Sport, an entity controlled by Jon E. Goodrich, a director of the Company, operated the Company's Security Products Segment. Effective May 1, 2002, the Management Agreement expired and the Company recommenced operation of the Security Products Segment.

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

|                                       | Car and<br>Truck Wash | Security<br>Products |
|---------------------------------------|-----------------------|----------------------|
| Three months ended September 30, 2003 |                       |                      |
| Revenues from external customers      | \$ 10,290             | \$ 1,58              |
| Intersegment revenues                 | \$ -                  | \$ -                 |
| Segment operating income (loss)       | \$ 728                | \$ 2                 |
| Segment assets                        | \$ 87,918             | \$ 6,82              |
| Nine months ended September 30, 2003  |                       |                      |
| Revenues from external customers      | \$ 32,936             | \$ 3,84              |
| Intersegment revenues                 | \$ -                  | \$ 2                 |
| Segment operating income (loss)       | \$ 3,380              | \$ (1                |
| Three months ended September 30, 2002 |                       |                      |
| Revenues from external customers      | \$ 10,671             | \$ 1,16              |
| Intersegment revenues                 | \$ -                  | \$ -                 |
| Segment operating income (loss)       | \$ 1,009              | \$ 14                |
| Nine months ended September 30, 2002  |                       |                      |
| Revenues from external customers      | \$ 33,804             | \$ 1,64              |
| Intersegment revenues                 | \$ -                  | \$ -                 |

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Segment operating income (loss) \$ 5,005 \$

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- \* 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.

### 10. 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 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 judgements about the carrying value of assets and liabilities that are not readily apparent from other sources. Some of those judgements can be subjective and complex, and consequently, actual results may differ from these estimates under different assumptions or conditions. 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.

### 11. Income Taxes

The Company recorded tax expense of \$42,000 and \$524,000 for the nine months ended September 30, 2003 and 2002, respectively. Tax expense reflects the recording of income taxes on income before the cumulative effect of a change in accounting principle at an effective rate of 36% in both 2003 and 2002. We recorded an income tax benefit of approximately \$2.2 million related to the cumulative effect of a change in accounting principle in 2002. The income tax benefit reflects an effective rate of 36% for the impairments in the Arizona and truck wash reporting units. No income tax benefit was recorded for the Northeast Region reporting unit impairment due to the non-deductibility of the goodwill. 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.

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### 12. Asset Impairment Charges

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 for possible impairment when events and circumstances warrant such a review. During the quarter ended June 30, 2003, we fully wrote down assets determined to be impaired by approximately \$351,000. The asset write-down related to a full service car wash site in Arizona which we partially wrote down at December 31, 2002. The additional write-down was the result of the impending loss of a significant customer at this site resulting in the future expected cash flows not being sufficient to recover the site's respective carrying values. The Company closed the facility effective September 30, 2003.



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### 13. Related Party Transactions

Effective August 1, 2000, Mace entered into a five-year lease with Bluepointe, Inc., a corporation controlled by Louis D. Paolino, Jr., Mace's Chairman, Chief Executive Officer and President, for Mace's executive offices in Mt. Laurel, New Jersey. The lease terms were subject to a survey of local real estate market pricing and approval by the Company's Audit Committee and provide for an initial monthly rental payment of \$15,962, which increases by 5% per year in the third through fifth years of the lease. Mace believes that the terms of this lease (based on an annual rate of \$19.00 per square foot ) are competitive when compared to similar facilities in the Mt. Laurel, New Jersey area. Mace has also entered into a three-year furniture lease/purchase agreement with Bluepointe, Inc., dated January 1, 2001, which provided for an initial payment of \$20,000 and monthly rental payments thereafter of \$4,513, for the use of the furnishings in Mace's executive offices. The rental rates were based upon a third-party valuation of the furnishings, and Mace believes that the terms of the furniture lease are competitive with similar leasing arrangements available in the local area.

The Company purchased charter airline services from Air Eastern, Inc., and LP Learjets, LLC, charter airline companies owned by Louis D. Paolino, Jr., the Company's Chairman, Chief Executive Officer and President. The Company incurred approximately \$5,000 in 2003 and \$29,000 in 2002 for such services. On November 6, 2001, the Audit Committee approved an arrangement subject to quarterly review under which the Company prepays LP Learjets, LLC \$5,109 per month for the right to use a Learjet 31A for 100 hours per year. Additionally, when the Learjet 31A is used, the Company pays to third parties unaffiliated with Louis D. Paolino, Jr., the direct costs of the Learjet's per-hour use, which include fuel, pilot fees, engine insurance and landing fees. As of July 2002, the Company is no longer prepaying LP Learjets, LLC for the future right to use the Learjet 31A.

In February 2000, the Company entered into a Management Agreement with Mark Sport, Inc. ("Mark Sport"), a Vermont corporation controlled by Jon E. Goodrich, a director of the Company. The Management Agreement entitled Mark Sport to operate the Company's Security Products Segment and receive all profits or losses for a seven-month term beginning January 1, 2000 in exchange for certain payments to the Company. The Management Agreement was extended several times through amendments. A February 21, 2002 amendment extended the term of the Management Agreement through April 30, 2002, and reconciled the amount owed by Mark Sport to the Company under the Management Agreement from February 2000 through December 31, 2001. Mark Sport and the Company agreed in the amendment that Mark Sport, as of December 31, 2001, owed the Company \$127,000, resulting in a resolution of certain disputes and a reduction of the amounts owed by Mark Sport of approximately \$92,000. The Management Agreement expired on April 30, 2002 and was further amended on July 22, 2002 to reconcile the amount owed by Mark Sport to Mace under the Management Agreement for the period January 1, 2002 through April 30, 2002. Mark Sport and Mace agreed in their final amendment that Mark Sport owed the Company \$100,000 for this period, resulting in a resolution of certain disputes and a reduction of the amounts recorded by the Company as owed by Mark Sport of approximately \$39,000. At September 30, 2003, Mark Sport owed the Company \$127,000.

The Company's Consumer Products Division leases manufacturing and office space under a five-year lease with Vermont Mill, Inc. ("Vermont Mill"), which provides for monthly lease payments of \$9,167 through November 2004. Vermont Mill is controlled by Jon E. Goodrich, a director of the Company. 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 further amended to provide Mace the option and right to cancel the lease with proper notice and a payment equal to six months of the then current rent for the leased space occupied by Mace.

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Vermont Mill borrowed a total of \$228,671 from the Company through December 31, 2001. On February 22, 2002, Vermont Mill executed a three year promissory note with monthly installments of \$7,061 including interest at a rate of 7%. The Company's Lease Agreement with Vermont Mill provides for a right of offset of lease payments against this promissory note in the event monthly payments are not made by Vermont Mill. At September 30, 2003, the balance owed on this promissory note was \$121,000.

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From January 1, 2003 through September 30, 2003, the Company's Electronic Surveillance Products Division sold approximately \$60,000 of electronic security equipment to DSS, Inc. Louis Paolino, III, the son of the Company's CEO, Louis D. Paolino, Jr., is a one-third owner of DSS, Inc. The pricing extended to DSS, Inc. is no more favorable than the pricing given to third party customers who purchase in similar volume. Additionally, DSS, Inc. was hired by the Company to install security cameras in several of the Company's car washes at an installation fee of \$6,800. At September 30, 2003, DSS, Inc. owed the Company approximately \$50,000.

#### 14. 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 |            | Nine Months Ended |
|--|--------------------|------------|-------------------|
|  | 9/30/03            | 9/30/02    | 9/30/03           |
| Numerator:   |                    |            |                   |
| (Loss) income before cumulative effect of a change in accounting principle     | \$ (182)           | \$ (116)   | \$                |
| Cumulative effect of a change in accounting principle, net of tax              | -                  | -          |                   |
| Net (loss) income  | \$ (182)           | \$ (116)   | \$                |
| Denominator:   |                    |            |                   |
| Denominator for basic (loss) income per share - weighted average shares.....   | 12,412,189         | 12,676,568 | 12,409,800        |
| Dilutive effect of options and warrants.....                                   | -                  | -          | 13,000            |
| Denominator for diluted (loss) income per share - weighted average shares..... | 12,412,189         | 12,676,568 | 12,422,800        |
| Basic and diluted (loss) income per share:                                     |                    |            |                   |
| (Loss) income before cumulative  |                    |            |                   |

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|  |    |        |    |        |    |
|--|----|--------|----|--------|----|
| effect of a change in accounting principle.....                    | \$ | (0.01) | \$ | (0.01) | \$ |
| Cumulative effect of a change in accounting principle, net of tax. |    | --     |    | -      |    |
| Net (loss) income.....   | \$ | (0.01) | \$ | (0.01) | \$ |

The effect of options and warrants for the three months ended September 30, 2003 and 2002 have not be included as they would be anti-dilutive.

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

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

#### Forward Looking Statements

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

#### Summary of Critical Accounting Policies

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

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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. We believe that our critical accounting policies include those described below.

### Revenue Recognition

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

Revenue from the Company's Security Products Segment is recognized when shipments are made, or for export sales when title has passed. The Company was paid \$20,000 per month, from January through April of 2002, under an agreement which allowed Mark Sport, an entity controlled by Jon E. Goodrich, a director of the Company, to operate the Company's Security Products Segment. These amounts are included under revenues from operating agreements.

### Goodwill

On January 1, 2002, we adopted SFAS 142, and as required, discontinued amortization of goodwill acquired prior to July 1, 2001. Additionally, SFAS 142 required that, within six months of adoption, the first phase of the goodwill transitional impairment testing be completed at the reporting unit level as of the date of adoption. 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. (See Note 3, Change in Accounting Principle.)

In accordance with SFAS 142, we also completed a 2002 annual impairment test as of November 30, 2002, and will be subject to an impairment test each year thereafter. Significant estimates and assumptions are used in assessing the fair value of the reporting units and determining impairment to goodwill (See Note 3, Change in Accounting Principle). We cannot guarantee that there will not be impairments in this or subsequent years.

### Other Intangible Assets

Other intangible assets consist primarily of deferred financing costs, trademarks, and establishing a registered national brand name. Prior to 2002, our trademarks and brand name were amortized on a straight-line basis over 15 years. In accordance with SFAS 142, Goodwill and Other Intangible Assets, our trademarks and brand name are considered to have indefinite lives, and as such, are no longer subject to amortization. These assets will be tested for impairment annually and whenever there is an impairment indicator. Deferred financing costs are amortized on a straight-line basis over the terms of the respective debt instruments. Customer lists and non-compete agreements are amortized on a straight-line basis over their respective estimated useful lives.

### Deferred Acquisition Costs

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

### Impairment of Long-Lived Assets

In accordance with SFAS 144, Accounting for the Impairment or Disposal of

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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. We evaluate the carrying value of long-lived assets for potential impairment on a reporting unit basis using undiscounted after-tax estimated cash flows or on an individual asset basis if the asset is to be held and used or held for sale.

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### Costs of Terminated Acquisitions

Our policy is to charge as an expense any previously capitalized expenditures relating to proposed acquisitions that in management's current opinion will not be consummated.

### 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 tax assets include tax loss and credit carryforwards and are reduced by a valuation allowance if, based on available evidence and management's judgment, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

### Deferred Revenue

The Company records a liability for gift certificates and ticket books and seasonal and annual passes sold at its car care locations but not yet redeemed. The Company estimates these unredeemed amounts based on gift certificates and ticket book sales and redemptions throughout the year as well as utilizing historical sales and redemption rates. Seasonal and annual passes are amortized on a straight-line basis over the time during which the passes are valid.

### Advertising

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

## Introduction

### Revenues

#### Car 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 nine months ended September 30, 2003 for the car care segment were comprised of approximately 82% car wash and detailing, 10% lube and other automotive services, and 8% fuel and merchandise.

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

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receipts, thus minimizing customer accounts receivable.

Weather can and has had a significant impact on volume at the individual locations. We believe that the geographic diversity of our operating locations helps spread the risk of adverse weather-related influence on our volume.

### Security Products

During 2000, 2001, and for the first four months of 2002, the Company was paid \$20,000 per month under a Management Agreement pursuant to which Mark Sport, an entity controlled by Jon E. Goodrich, a director of the Company, operated the Security Products Segment. Effective May 1, 2002, the Management Agreement expired and the Company recommenced operation of the Security Products Segment. Prior to the acquisition of Micro-Tech, the Company operated its Security Products Segment solely as the Consumer Products Division. The Company's Consumer Products operations manufacture and market personal safety, and home and auto security products which are sold through retail stores, major discount stores, domestic and international distributors, and at the Company's car care facilities.

With the acquisition on August 12, 2002 of certain of the assets and operations of Micro-Tech, a manufacturer and retailer of electronic security and surveillance devices, the Company added an additional division to its Security Products Segment. The Company has added security cameras, closed-circuit monitors, digital video recording devices and related electronic security components to its line of well-known personal security products. The Company is purchasing these items for resale from Original Equipment Manufactures ("OEMs").

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### Cost of Revenues

#### Car and Truck Wash Services

Cost of revenues consists primarily of direct labor and related taxes and 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.

#### Security Products

For the first four months of 2002, the Security Products segment was operated under a Management Agreement by Mark Sport. Accordingly, during that time, no costs were incurred by the Company. Cost of revenues within the Security Products Segment consists primarily of costs to purchase or manufacture the security products including direct labor and related taxes and benefits, and raw material costs. Product return and warranty costs related to the new electronic security surveillance product business have been minimal in that the majority of customer product warranty claims are reimbursed by the manufacturer.

### Selling, General and Administrative Expenses

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

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

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The Company also charges as an expense any capitalized expenditures relating to proposed acquisitions that will not be consummated.

### 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 15 years, using the straight-line method. With the adoption of SFAS 142 on January 1, 2002, we no longer amortize goodwill and certain intangible assets, namely trademarks and service marks, determined to have indefinite useful lives.

### Other Income

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

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### 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, fixed asset adjustments and changes to the valuation allowance.

### Liquidity and Capital Resources

#### Liquidity

Cash and cash equivalents were \$3.9 million at September 30, 2003. The ratio of our total debt to total capitalization, which consists of total debt plus stockholders' equity, was 35% at September 30, 2003, and 37% at December 31, 2002.

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

As of September 30, 2003, we had negative working capital of approximately \$4.6 million. At December 31, 2002, working capital was a negative \$2.2 million. The negative working capital position at September 30, 2003 is primarily attributable to the classification of five 15-year amortizing loans with the Company's principal lender, Bank One, N.A. ("Bank One"), totaling approximately \$9.1 million classified as current liabilities at September 30, 2003 as a result of these loans being due beginning from November 2003 through August 2004. The Company intends to renew these loans with the current lender. Although the Company has been successful in renewing similar loans with the current lender in the past, including the renewal of two loans in February 2003 totaling \$4.7 million for a five-year period, and a loan for \$730,000 in July 2003, there can be no assurance that our lender will continue to provide us with renewals, with

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renewals at favorable terms, or that we may be able to obtain favorable terms from an alternative funding source. If we were unable to obtain renewals of or refinancings on favorable terms, our ability to operate would be materially and adversely affected.

We estimate aggregate capital expenditures for our Car and Truck Wash Segment, exclusive of acquisitions of businesses, of approximately \$200,000 for the remainder of the year ending December 31, 2003. In October 2002, we purchased a building as a warehouse, production and administrative facility for our new electronic surveillance products operations. We financed a portion of the \$505,000 purchase price of this building with a long-term mortgage of approximately \$400,000. In October 2003, we increased this mortgage to \$729,000, utilizing the funds to purchase additional warehouse space and improve office space. In addition to the purchase of the electronic surveillance products business and facility, we will also expend significant cash to purchase inventory as we continue to introduce new electronic surveillance products and for improvements to the facility purchased in 2002. We spent approximately \$2.2 million for inventory of newly developed electronic surveillance products and approximately \$100,000 for capital improvements, furnishing and equipment for the facility through the nine months ending September 30, 2003.

### Debt Capitalization and Other Financing Arrangements

At September 30, 2003, we had borrowings of approximately \$31.5 million. We had three letters of credit outstanding at September 30, 2003, totaling \$825,000 as collateral relating to workers' compensation insurance policies. We maintain a \$500,000 revolving credit facility to provide financing for additional electronic surveillance product inventory purchases. There were no borrowings outstanding under the revolving credit facility at September 30, 2003.

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During 2000 and 2001, we refinanced on a long term basis under favorable terms the majority of our short term debt related to our 1999 and 2000 acquisitions. 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. At September 30, 2003, we were not in compliance with our consolidated debt coverage ratio related to our GMAC notes payable and a subsidiary level cash flow covenant with Bank One related to Colonial Full Service Car Wash, Inc. ("Colonial"). With respect to the GMAC notes payable and the Bank One notes payable, the Company has received waivers of acceleration of the notes through October 1, 2004. Additionally, the Company has entered into amendments to the Bank One term loan agreements and a modification agreement to a loan agreement with Wachovia Bank, N.A. ("Wachovia") as of December 31, 2002. The Company is currently in compliance with the Wachovia covenants as amended. The Company initiated certain temporary and permanent cost savings measures in March of 2003 including reductions in payroll expense and certain operating costs to enable it to maintain compliance with the Bank One consolidated debt coverage ratio. These savings through September 30, 2003, totaled approximately \$375,000. The amended debt coverage ratio with Bank One requires the Company to maintain a consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA") to debt service ("the debt coverage ratio") of 1.2 to 1 at December 31, 2003 and thereafter, and a 1.1 to 1 ratio for the twelve month period ending September 30, 2003. If we 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. If the Company is unable to obtain waivers or amendments in the future, Bank One debt totaling \$5.6 million and GMAC debt totaling \$11.0 million recorded as long-term



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debt at September 30, 2003 would become due on demand.

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. Our cash flow has been and could continue to be adversely affected by weather patterns and economic conditions. 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. Although the Company believes that it would be successful in resolving potential non-compliance with its debt covenants, or refinancing its current debt, 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 of or refinancings 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 care 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. Future minimum lease payments under operating leases with initial or remaining noncancellable lease terms in excess of one year as of September 30, 2003 are as follows: Year 1 - \$1.3 million; Year 2 - \$1.1 million; Year 3 - \$688,000; Year 4 - \$529,000; Year 5 - \$412,000; and thereafter - \$1.3 million.

The following are summaries of our contractual obligations and other commercial commitments at September 30, 2003 (in thousands):

| Payments Due By Period           |           |                       |                       |                       |
|----------------------------------|-----------|-----------------------|-----------------------|-----------------------|
| Contractual Obligations          | Total     | Less than<br>One Year | Two to<br>Three Years | Four to Five<br>Years |
| Long-term debt                   | \$ 31,085 | \$ 10,486             | \$ 4,238              | \$ 6,442              |
| Capital leases                   | 391       | 174                   | 175                   | 42                    |
| Minimum operating lease payments | 5,287     | 1,305                 | 1,740                 | 941                   |
|                                  | \$ 36,763 | \$ 11,965             | \$ 6,153              | \$ 7,425              |

| Amounts Expiring Per Period  |       |                       |                       |                       |
|------------------------------|-------|-----------------------|-----------------------|-----------------------|
| Other Commercial Commitments | Total | Less Than<br>One Year | Two to<br>Three Years | Four to<br>Five Years |
|                              |       |                       |                       |                       |

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|                           |    |       |       |       |    |   |    |   |
|---------------------------|----|-------|-------|-------|----|---|----|---|
| Line of Credit            | \$ | 500   | (1)\$ | 500   | \$ | - | \$ | - |
| Standby Letters of Credit |    | 825   |       | 825   |    | - |    | - |
|                           | \$ | 1,325 | \$    | 1,325 | \$ | - | \$ | - |

(1) There were no borrowings outstanding under the Company's line of credit at September 30, 2003

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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 to purchase directly from us shares of our unrestricted common stock. Each equity purchase agreement is to be in an aggregate principal amount of \$12.0 million. The first equity purchase agreement was entered into on April 17, 2000. Fusion had the right to terminate the first equity purchase agreement on or after February 20, 2003. In the Company's Form 10-K for the fiscal year ended December 31, 2002, the Company described the first equity purchase agreement as having expired on February 20, 2003. On April 11, 2003 Fusion notified the Company that Fusion did not terminate the first equity agreement and further agreed not to terminate it until on or after February 20, 2005; accordingly, the first equity purchase agreement is still in effect. The equity purchase agreement allows us to suspend the purchasing of our common stock by Fusion if the price of our common stock is less than \$7.00 (pre-reverse split) 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 (pre-reverse split), whichever is greater or (2) a price based upon the lower of (a) the lowest sale price of the common stock during the 12 consecutive trading days immediately preceding Fusion's purchase and (b) the lowest closing bid price for the common stock during the 12 consecutive trading days ending on the day prior to Fusion's purchase. 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. Proceeds from purchased shares through December 31, 2001 totaled approximately \$1.3 million. 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. The description of the equity purchase agreement and master facility agreement is summarized above. The equity purchase agreement and the master facility agreement have been filed as exhibits 10.128 and 10.129 as noted in our December 31, 2002 Form 10-K.

Cash Flows

Operating Activities. Net cash provided by operating activities totaled \$326,000 for the nine months ended September 30, 2003. Cash provided by operating

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activities in 2003 was impacted primarily by reduced volume within the Car and Truck Wash Segment due to above average inclement weather in the Company's Texas and East operating regions and the purchasing of our initial inventory of electronic surveillance products.

Investing Activities. Cash used in investing activities totaled \$726,000 for the nine months ended September 30, 2003 which reflects \$606,000 for capital expenditures relating to ongoing car care operations, and \$106,000 for the Security Products Segment.

Financing Activities. Cash used in financing activities was \$1.8 million for the nine months ended September 30, 2003 which reflects routine principal payments on debt of \$1.8 million and \$14,000 for the purchase and retirement of shares of our common stock.

### Seasonality and Inflation

The Company believes that its car washing and detailing operations are adversely affected by periods of inclement weather. In particular, long periods of rain and cloudy weather can adversely affect our car wash volumes and related lube and other automotive services as people typically do not wash their cars during such periods. Additionally, extended periods of warm, dry weather, usually encountered during the Company's third quarter, may encourage customers to wash their cars themselves which also can adversely affect our car wash business. The Company has attempted to mitigate the risk of unfavorable weather patterns by having operations in diverse geographic regions. The Company also experiences a seasonal reduction in volume during the third quarter within the Company's Arizona and Florida regions as a result of a migration of a significant portion of the area's population to cooler climates.

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.

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### Results of Operations for the Nine Months Ended September 30, 2003 Compared to the Nine Months Ended September 30, 2002

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

|  | Nine Months E<br>September 3<br>2003 |
|--|--------------------------------------|
| Revenues                                     | 100.0%                               |
| Cost of revenues                             | 72.9                                 |
| Selling, general and administrative expenses | 18.4                                 |
| Depreciation and amortization                | 4.0                                  |
| Costs of terminated acquisitions             | -                                    |
| Asset impairment charge                      | 1.0                                  |
| Operating income                             | 3.7                                  |
| Interest expense, net                        | (4.0)                                |
| Other income                                 | 0.6                                  |

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|   |       |
|---|-------|
| Income before income taxes  | 0.3   |
| Income tax expense  | 0.1   |
|   | ----- |
| Income before cumulative effect of a change in accounting principle | 0.2   |
| Cumulative effect of a change in accounting principle, net of tax   | -     |
|   | ----- |
| Net income (loss)   | 0.2%  |
|   | ===== |

### Revenues

#### Car and Truck Wash Services

Revenues for the nine months ended September 30, 2003 were \$32.9 million as compared to \$33.8 million for the nine months ended September 30, 2002, a decrease of \$0.9 million or 3%. This decrease was primarily attributable to a decrease in wash and detail services. Of the \$32.9 million of revenues for the nine months ended September 30, 2003, \$27.1 million or 82% was generated from car wash and detailing, \$3.1 million or 10% from lube and other automotive services, and \$2.7 million or 8% from fuel and merchandise sales. Of the \$33.8 million of revenues for the nine months ended September 30, 2002, \$28.2 million or 84% was generated from car wash and detailing, \$3.2 million or 9% from lube and other automotive services, and \$2.4 million or 7% from fuel and merchandise sales. The decrease in wash and detailing revenues was principally due to an approximate 8% decrease in wash volume in 2003 as compared to 2002 as a result of more rainy and cloudy days in substantially all of the Company's markets in 2003. The volume decrease was partially offset by an increase in the average total wash and detailing revenue per car of approximately 4%.

#### Security Products

During the first four months of 2002, pursuant to a Management Agreement, the Company was paid \$20,000 per month. These amounts are included under revenues from operating agreements. Effective May 1, 2002, the Company recommenced operation of the Security Products Segment and payments under the Management Agreement were terminated. Revenues for the nine months ended September 30, 2003 were \$3.8 million comprised of approximately \$2.1 million from the Consumer Products Division and approximately \$1.7 million from the Electronic Surveillance Products Division. Revenues for the five months in which the Company operated this segment during the first nine months of 2002, May through September, were approximately \$1.6 million.

### Cost of Revenues

#### Car and Truck Wash Services

Cost of revenues for the nine months ended September 30, 2003 were \$24.6 million, or 75% of revenues, with car washing and detailing costs at 73% of respective revenues, lube and other automotive services costs at 77% of respective revenues, and fuel and merchandise costs at 88% of respective revenues. Cost of revenues for the nine months ended September 30, 2002 were \$24.0 million, or 71% of revenues, with car washing and detailing costs at 69% of respective revenues, lube and other automotive services costs at 79% of respective revenues, and fuel and merchandise costs at 87% of respective

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revenues. The Company has experienced a deterioration in wash and detailing operating margins largely due to a decrease in wash volume of 8% as compared to the same period in the prior year, combined with increased insurance premiums and related claim costs, lease termination costs related to an underperforming car wash property closed in 2003, and an increase in labor costs as a percent of revenues of approximately two percentage points. This deterioration in wash and detailing operating margins was partially offset by certain temporary and permanent cost savings measures instituted in March of 2003, including reductions in payroll and related benefit costs and certain other operating expenses.

### Security Products

For the nine months ended September 30, 2003, cost of revenues were \$2.2 million or 58% of revenues. Through April of 2002, pursuant to a Management Agreement, no costs were incurred by us. From May through September of 2002, cost of revenues were \$868,000 or 55% of revenues.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for the nine months ended September 30, 2003 were \$6.8 million compared to \$6.2 million for the same period in 2002, an increase of approximately \$0.6 million or 10%. SG&A expenses as a percent of revenues were 18.4% for the nine months ended September 30, 2003 as compared to 17.4% in the first nine months of 2002. The increase in SG&A expenses is primarily the result of recommencing operation of the Security Products Segment in May 2002, which added \$1.0 million of SG&A expenses in the first nine months of 2003. This increase in SG&A expenses was partially offset by certain temporary and permanent cost savings measures instituted in March of 2003, including reductions in payroll and related benefit costs and certain other operating expenses.

### Depreciation and Amortization

Depreciation and amortization totaled \$1.5 million for the nine months ended September 30, 2003 as compared to \$1.5 million for the same period in 2002.

### Asset Impairment Charges

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 for possible impairment when events and circumstances warrant such a review. During the quarter ended June 30, 2003, we wrote down assets determined to be impaired by approximately \$351,000. The asset write-down related to a full service car wash site in Arizona which we partially wrote down at December 31, 2002. The additional write-down was the result of the impending loss of a significant customer of this site resulting in the future expected cash flows not being sufficient to recover the site's carrying value. The Company closed the facility effective September 30, 2003.

### Interest Expense, Net

Interest expense, net of interest income, for the nine months ended September 30, 2003 was \$1.5 million compared to \$1.7 million for the nine months ended September 30, 2002. 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

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Other income for the nine months ended September 30, 2003 was \$210,000 compared to \$230,000 for the nine months ended September 30, 2002.

### Income Taxes

The Company recorded tax expense of \$42,000 and \$524,000 for the nine months ended September 30, 2003 and 2002, respectively. Tax expense reflects the recording of income taxes on income before cumulative effect of a change in accounting principle at an effective rate of approximately 36% in both 2003 and 2002. We recorded an income tax benefit of approximately \$2.2 million related to the cumulative effect of a change in accounting principle in 2002. The income tax benefit reflects an effective rate of 36% for the impairments in the Arizona and truck wash reporting units. No income tax benefit was recorded for the Northeast Region reporting unit impairment due to the non-deductibility of the goodwill. 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.

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### Results of Operations for the Three Months Ended September 30, 2003 Compared to the Three Months Ended September 30, 2002

#### Revenues

##### Car and Truck Wash Services

Revenues for the three months ended September 30, 2003 were \$10.3 million as compared to \$10.7 million for the three months ended September 30, 2002, a decrease of \$0.4 million or 4%. This decrease was primarily attributable to a decrease in wash and detail services. Of the \$10.3 million of revenues for the three months ended September 30, 2003, \$8.3 million or 80% was generated from car wash and detailing, \$1.1 million or 11% from lube and other automotive services, and \$0.9 million or 9% from fuel and merchandise sales. Of the \$10.7 million of revenues for the three months ended September 30, 2002, \$8.7 million or 82% was generated from car wash and detailing, \$1.1 million or 10% from lube and other automotive services, and \$0.9 million or 8% from fuel and merchandise sales. The decrease in wash and detailing revenues was principally due to a 10% decrease in wash volume in the three months ending September 30, 2003 as compared to the same period in 2002 as a result of more rainy and cloudy days in the Company's Texas and Northeast regions in 2003. The volume decrease was partially offset by an increase in the average total wash and detailing revenue per car of approximately 5%.

##### Security Products

During the first four months of 2002, pursuant to a Management Agreement, the Company was paid \$20,000 per month. These amounts are included under revenues from operating agreements. Effective May 1, 2002, the Company recommenced operation of the Security Products Segment and payments under the Management Agreement were terminated. Revenues for the three months ended September 30, 2003 were \$1.6 million comprised of approximately \$770,000 from the Consumer Products Division and approximately \$820,000 from the Electronic Surveillance Products Division. Revenues for the three months ended September 30, 2002 were approximately \$1.2 million.

#### Cost of Revenues

##### Car and Truck Wash Services

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Cost of revenues for the three months ended September 30, 2003 were \$8.0 million, or 78% of revenues, with car washing and detailing costs at 77% of respective revenues, lube and other automotive services costs at 75% of respective revenues, and fuel and merchandise costs at 89% of respective revenues. Cost of revenues for the three months ended September 30, 2002 were \$8.1 million, or 75% of revenues, with car washing and detailing costs at 74% of respective revenues, lube and other automotive services costs at 79% of respective revenues, and fuel and merchandise costs at 87% of respective revenues. The Company has experienced a deterioration in wash and detailing operating margins largely due to a decrease in wash volume of 10% as compared to the same quarter in the prior year, combined with lease termination costs related to an underperforming car wash property in Arizona closed in 2003, and an increase in labor costs as a percent of revenues of approximately two percentage points. This deterioration in wash and detailing operating margins was partially offset by certain temporary and permanent cost savings measures instituted in March of 2003, including reductions in payroll and related benefit costs.

### Security Products

During the three months ended September 30, 2003, cost of revenues were \$914,000 or 58% of revenues as compared to \$643,000 or 55% of revenues for the three months ended September 30, 2002.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses for the three months ended September 30, 2003 were \$2.3 million compared to \$2.3 million for the same period in 2002. SG&A expenses as a percent of revenues were 19.6% for the three months ended September 30, 2003 as compared to 19.6% in the third quarter of 2002. SG&A expenses increased as a result of entering the electronic security surveillance business in August 2002, which added \$277,000 of SG&A expenses in the third quarter of 2003. This increase in SG&A expenses was offset by certain temporary and permanent cost savings measures instituted in March of 2003, including reductions in payroll and related benefit costs.

### Depreciation and Amortization

Depreciation and amortization totaled \$487,000 for the three months ended September 30, 2003 as compared to \$474,000 for the same period in 2002.

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### Interest Expense, Net

Interest expense, net of interest income, for the three months ended September 30, 2003 was \$443,000 compared to \$553,000 for the three months ended September 30, 2002. This decrease in interest expense was 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, a retroactive interest rate adjustment on a note payable, and a reduction in our outstanding debt as a result of normal principal payments.

### Other Income (Expense)

Other income (expense) for the three months ended September 30, 2003 was \$43,000 compared to \$82,000 for the three months ended September 30, 2002, primarily as a result of a reserve for \$100,000 against a note receivable (see Note 8, Commitments and Contingencies) partially offset by an insurance reimbursement in

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the third quarter of 2003 for lost profit due to a fire at one of our car wash facilities.

### Income Taxes

The Company recorded tax benefit of \$102,000 and \$65,000 for the three months ended September 30, 2003 and 2002, respectively. Tax benefit reflects the recording of income taxes on loss before income taxes at an effective rate of approximately 36% in both 2003 and 2002. 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

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. These risks and uncertainties are set forth herein and in the Company's 2002 Form 10-K and as may be set forth in the Company's subsequent press releases and/or Forms 10-Q, 8-K, and other filings with the Securities and Exchange Commission. 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.

Our business plan poses risks for us. Our business objectives include internally developing our Electronic Surveillance Products Division and acquiring additional car washes, if we can do so under advantageous terms. To date, we have spent or committed to spend approximately \$3.0 million in developing our Electronic Surveillance Products Division including the acquisition cost of Micro-Tech, the purchase of our warehouse in Hollywood, Florida, and the cost of developing and purchasing our expanded inventory product line. As part of our business plan we may also develop or acquire additional car wash facilities. Our strategy involves a number of risks, including:

- i. risks associated with growth;
- ii. risks associated with acquisitions; and their integration into our Company.
- iii. risks associated with the recruitment and development of management and operating personnel; and
- iv. risks of not being able to sell the electronic surveillance products in the quantities we have ordered from OEM manufacturers.

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



Risk related to borrowings. Our borrowings as of September 30, 2003 were \$31.5 million. Of the borrowings, \$10.7 million is classified as current as it is due in less than twelve months. Our business plan is dependent on refinancing the debt as it becomes due. 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. At September 30, 2003, we were not in compliance with our consolidated debt coverage ratio related to our GMAC notes payable and a subsidiary level covenant with Bank One related to Colonial Full Service Car Wash, Inc. ("Colonial"). With respect to the GMAC notes payable and the Bank One notes payable related to Colonial, the Company has received waivers of acceleration of the notes through October 1, 2004. Additionally, the Company has entered into amendments to the Bank One term loan agreements and a modification agreement to a loan agreement with Wachovia Bank N.A. as of December 31, 2002. The Company is currently in compliance with these covenants as amended. The Company initiated certain temporary and permanent cost savings measures in March of 2003 including reductions in payroll expense and certain operating costs to enable it to maintain compliance with the Bank One consolidated debt coverage ratio. These savings through September 30, 2003, totaled approximately \$375,000. The amended debt coverage ratio with Bank One requires the Company to maintain a consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA") to debt service ("the debt coverage ratio") of 1.2 to 1 at December 31, 2003 and thereafter, and a 1.1 to 1 ratio for the twelve month period ending September 30, 2003. If we 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. If the Company is unable to obtain waivers or amendments in the future, Bank One debt totaling \$5.6 million and GMAC debt totaling \$11.0 million currently recorded as long-term debt at September 30, 2003 would become due on demand.

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. Our cash flow has been and can continue to be adversely affected by weather patterns and the economic climate. In the event that non-compliance with the debt covenants should reoccur, the Company would pursue various alternatives 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. Although the Company believes that it would be successful in resolving potential non-compliance with its debt covenants, or refinancing its current debt, 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 of or refinancings on favorable terms, our ability to operate would be materially and adversely affected.

Our operations are dependent substantially on the services of our executive officers. If we lose one or more of our executive officers and do not replace them with experienced personnel, 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. The primary terms of the employment agreements of Robert M. Kramer, Gregory M. Krzemien and Ronald R. Pirollo expired on March 26, 2003. Mr. Paolino and the Company have executed an employment agreement which has a term through August 12, 2006. Messrs. Kramer and Krzemien are working on a month-to-month at-will basis. Mr. Pirollo or the Company may terminate Mr. Pirollo's employment at any time. Mr. Paolino is the Company's Chief Executive Officer; Mr. Kramer is the Company's Chief Operating Officer, General Counsel and Secretary; Mr. Krzemien is the Company's Chief

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Financial Officer and Treasurer; and Mr. Pirollo is the Company's Chief Accounting Officer and Corporate Controller. The Company and the officers named above, except Mr. Paolino, are in the process of negotiating their continued employment arrangements.

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

We have a limited operating history regarding our Electronic Surveillance Products Division. We recently expanded our line of security products by adding the Electronic Surveillance Products Division. We are incurring expenses to develop the new line of products without having extensively tested the size or possible profitability of the market for such products. There are numerous risks associated with the new Electronic Surveillance Products that may prevent the Company from making them profitably, including, among others: risks associated with unanticipated problems in the acquired company; risks inherent with our management having limited experience in electronic security device marketing; risks relating to the size and number of competitors in the electronic security device market, many of whom may be more experienced or better financed; risks associated with the costs of planned entry into new markets and expansion of product lines in old markets; and risks attendant to locating and maintaining reliable sources of OEM products and component supplies in the electronic surveillance industry. 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 new business.

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.

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,

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gasoline stations, gasoline companies, automotive companies and specialty stores, both regional and national.

Consumer demand for our car wash services is unpredictable. 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. 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 in car washes results in frequent mechanical problems. If we fail to properly maintain the equipment, any car wash could become inoperable resulting in a loss of its revenue. Many of our car washes have older equipment which requires frequent repair or replacement.

We must operate our locations safely. Our Consumer Products Division and Car and Truck Wash Segment utilize harsh chemicals in their operations. Our Car and Truck Wash Segment employs approximately 1,400 people. Though we train our personnel in safety, there is a risk of injury to our employees.

We face risks associated with significant insurance claims. We maintain workers' compensation insurance 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 parties. With respect to our auto, general liability and workers' compensation policies, we are required to set aside a certain amount of cash in a restricted "loss fund" account for the payment of our deductible obligations under the policies up to the first \$300,000 per claim. As a member of the captive, we are obligated to pay assessments to the captive insurance program. The assessments are secured by a letter of credit in the amount of \$525,000 at September 30, 2003. If our loss experience is worse than expected, our assessments to the captive may be increased in the future year. The Company maintains excess coverage through occurrence-based policies. There can be no assurance that our insurance program will provide sufficient coverage in the event that a claim exceeds our insurance coverage or the captive insurer fails to pay its claims, 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.

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. 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 wastes;
- ii. discharge of storm water; and
- iii. underground storage tanks.

If uncontrolled hazardous 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

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on our financial condition and results of operations.

We face risks associated with our consumer safety products. We face claims of injury allegedly resulting from our defense sprays. 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 the event a lawsuit is brought against us, we cannot give assurance that our insurance coverage will be sufficient to cover any judgments won. If our insurance coverage is exceeded, we will have to pay the excess liability directly.

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Listing on the Nasdaq National Market. Our common stock is listed on the Nasdaq National Market and a bid price of \$1.61 at the close of the market on November 6, 2003. 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 listing on the Nasdaq National Market. If our stock fails to 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 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"). 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."

On October 2, 2002, Nasdaq advised the Company that its common stock failed to maintain a minimum bid price of \$1.00 over the prior 30 consecutive trading days as required by the Nasdaq National Market under its Marketplace Rules. Nasdaq advised us that we had 90 days to maintain a bid price of at least \$1.00 for 10 consecutive business days or we would be delisted. The Company maintained a minimum bid price of at least \$1.00 for 10 consecutive business days ending December 24, 2002, in part by completing a one-for-two reverse stock split on December 17, 2002. On December 30, 2002, Nasdaq advised the Company that it was in compliance with Market Place Rule 4450(a)(5) and was not subject to being delisted.

Our stock price is volatile. Our common stock's market price has been 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.

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 million 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 years, unless approved in a prescribed manner. This provision of Delaware law may affect our ability to merge with, or to engage in other similar activities with, some other companies. This means that we may be a less attractive target to a potential acquirer who otherwise may be willing to pay a price for our common stock above its market price.

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

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

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

There has been no material change in our exposure to market risks arising from fluctuations in foreign currency exchange rates, commodity prices, equity prices or market interest rates since December 31, 2002 as reported on our Form 10-K for the year ended December 31, 2002.

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### Item 4. Controls and Procedures

The Company's management conducted an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of October 9, 2003. Based on this evaluation and as of the date of the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in alerting them in a timely manner to material information required to be included in the Company's SEC reports. In addition, management, including the Chief Executive Officer and Chief Financial Officer, reviewed the Company's internal controls, and there have been no significant changes in the Company's internal controls or in other factors that could significantly affect those controls subsequent to the date of their last evaluation.

## PART II

### OTHER INFORMATION

#### Item 1. Legal Proceedings

Information regarding our legal proceedings can be found in Note 8, Commitments and Contingencies.

#### Item 5. Other Information

The Company's 2004 Annual Meeting of the Stockholders is currently expected to be held on September 15, 2004. June 15, 2004 is the deadline for the stockholders to submit proposals pursuant to Rule 14a-8 of the Exchange Act for inclusion in Mace's Proxy Statement for Mace's 2004 Annual Meeting of Stockholders. If a stockholder gives notice of a proposal after this deadline, the proxies will be allowed to use their discretionary authority to vote against such matter when and if raised at the 2004 meeting.

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

##### (a) Exhibits:

- 10.153 Consolidated Promissory Note and Amended and Restated Loan Agreement dated October 20, 2003 between the Company, its wholly owned subsidiary, Mace Security Products, Inc. and Wachovia Bank, N.A. in the amount of \$728,800.
- 10.154 Amendment dated October 25, 2003 to Employment Contract dated August 12, 2003 by and between Mace Security International, Inc. and Louis D. Paolino, Jr.
- 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.

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

On August 12, 2003, the Company filed a report on Form 8-K dated August 12, 2003, under Item 7 and Item 12, to report the issuance of a

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press release announcing the Company's financial results for the fiscal quarter and six month period ended June 30, 2003.

On October 29, 2003, The Company filed a report on Form 8-K dated October 29, 2003 under Item 5 and Item 7 to (i) report the resignation of one of its directors, Richard B. Muir, due to business commitments and (ii) the election of Burton Segal to fill the vacancy created by Mr. Muir's resignation.

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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.

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

BY: /s/ Gregory M. Krzemien

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Gregory M. Krzemien, Chief Financial Officer

BY: /s/ Ronald R. Pirollo

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Ronald R. Pirollo, Controller (Principal Accounting Officer)

DATE: November 12, 2003

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### EXHIBIT INDEX

Exhibit No. Description

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|--------|--|
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