

Consolidated Financial Statements and
Independent Auditors' Report

Mace Security International, Inc.

December 31, 2016 and 2015



SKODA MINOTTI

CPAs, BUSINESS & FINANCIAL ADVISORS

Delivering on the Promise.

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Delivering on the Promise.

Independent Auditors' Report

To the Board of Directors

Mace Security International, Inc. and Subsidiaries

We have audited the accompanying consolidated financial statements of Mace Security International, Inc. and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mace Security International, Inc. and Subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

SKODA MINOTTI & CO.

Cleveland, Ohio
February 21, 2017

Mace Security International, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share information)

ASSETS	2016	2015
Current assets:		
Cash and cash equivalents	\$ 970	\$ 446
Restricted cash	60	60
Short-term investments	1,794	2,142
Accounts receivable, less allowance for doubtful accounts of \$114 and \$251 in 2016 and 2015, respectively	1,655	1,562
Inventories	1,568	1,601
Prepaid expenses and other current assets	952	779
Assets held for sale	-	430
Total current assets	6,999	7,020
Property and equipment:		
Buildings and leasehold improvements	216	216
Machinery and equipment	2,405	2,017
Furniture and fixtures	342	384
Total property and equipment	2,963	2,617
Accumulated depreciation and amortization	(2,249)	(2,095)
Total property and equipment, net	714	522
Other intangible assets, net	685	685
Other assets	1,184	1,034
Total other assets	1,869	1,719
Total assets	\$ 9,582	\$ 9,261

LIABILITIES AND STOCKHOLDERS' EQUITY	2016	2015
Current liabilities:		
Accounts payable	\$ 194	\$ 222
Income taxes payable	60	61
Accrued expenses and other current liabilities	518	695
	<u>772</u>	<u>978</u>
Total current liabilities		
Other liabilities	4	-
	<u>776</u>	<u>978</u>
Total liabilities		
Stockholders' equity:		
Preferred stock, \$.01 par value; authorized 10,000,000 shares, no shares issued and outstanding at December 31, 2016 and 2015	-	-
Common stock, \$.01 par value; authorized 100,000,000 shares, issued and outstanding shares of 60,781,858 and 60,285,370 at December 31, 2016 and 2015, respectively	608	603
Additional paid-in capital	102,098	101,859
Accumulated deficit	(93,863)	(94,113)
Accumulated other comprehensive loss	(15)	(44)
	<u>8,828</u>	<u>8,305</u>
Less treasury stock at cost, 90,548 shares in both 2016 and 2015	(22)	(22)
	<u>8,806</u>	<u>8,283</u>
Total stockholders' equity		
Total liabilities and stockholders' equity	<u>\$ 9,582</u>	<u>\$ 9,261</u>

The accompanying notes are an integral part of these consolidated financial statements.

Mace Security International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS

For the Years Ended December 31, 2016 and 2015
(Amounts in thousands, except per share data)

	<u>2016</u>	<u>2015</u>
Net revenue	\$ 9,054	\$ 7,145
Cost of revenue	<u>5,369</u>	<u>4,390</u>
Gross profit	3,685	2,755
Selling, general, and administrative expenses	3,719	3,838
Depreciation	<u>155</u>	<u>140</u>
Operating loss	(189)	(1,223)
Interest expense	(48)	(51)
Interest income	136	179
Loss on sale of short-term investments	(15)	(21)
Other income (expense), net	<u>(4)</u>	<u>296</u>
Loss from continuing operations before income tax provision	(120)	(820)
Income tax (benefit) provision	<u>(19)</u>	<u>1</u>
Loss from continuing operations	(101)	(821)
Income (loss) from discontinued operations, net of tax of \$0 and \$1 in 2016 and 2015, respectively	<u>351</u>	<u>(206)</u>
Net income (loss)	<u>\$ 250</u>	<u>\$ (1,027)</u>
Loss per share from continuing operations		
Basic	\$ (0.00)	\$ (0.01)
Diluted	\$ (0.00)	\$ (0.01)
Income (loss) per share from discontinued operations, net of tax		
Basic	\$ 0.01	\$ (0.00)
Diluted	\$ 0.01	\$ (0.00)
Net income (loss) per share		
Basic	\$ 0.00	\$ (0.02)
Diluted	\$ 0.00	\$ (0.02)
Weighted-average number of common shares (basic)	60,498	59,197
Weighted-average number of common shares (diluted)	61,444	59,197

The accompanying notes are an integral part of these consolidated financial statements.

Mace Security International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

For the Years Ended December 31, 2016 and 2015

(Amounts in thousands, except per share data)

	<u>2016</u>	<u>2015</u>
Net income (loss)	\$ 250	\$ (1,027)
Other comprehensive income net of tax of \$0 in both 2016 and 2015:		
Unrealized gain on short-term investments	<u>29</u>	<u>1</u>
Total comprehensive income (loss)	<u>\$ 279</u>	<u>\$ (1,026)</u>

The accompanying notes are an integral part of these consolidated financial statements.

Mace Security International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2016 and 2015
(Amounts in thousands, except share information)

	<u>Common Stock</u>		<u>Additional</u>	<u>Accumulated</u>	<u>Treasury</u>	<u>Accumulated</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u>	<u>Deficit</u>	<u>Stock</u>	<u>Other</u>	
			<u>Capital</u>			<u>Comprehensive</u>	
						<u>Income (Loss)</u>	
Balance at December 31, 2014	59,106,441	591	102,848	(93,086)	(22)	(45)	10,286
Stock-based compensation	-	-	165	-	-	-	165
Retirement of convertible debt	-	-	(1,378)	-	-	-	(1,378)
Unrealized gain on short-term investment	-	-	-	-	-	1	1
Exercise of stock warrants	1,178,929	12	224	-	-	-	236
Net loss	-	-	-	(1,027)	-	-	(1,027)
Balance at December 31, 2015	60,285,370	603	101,859	(94,113)	(22)	(44)	8,283
Stock-based compensation	-	-	194	-	-	-	194
Unrealized gain on short-term investment	-	-	-	-	-	29	29
Exercise of stock warrants	196,488	2	(2)	-	-	-	-
Exercise of stock options	300,000	3	47	-	-	-	50
Net income	-	-	-	250	-	-	250
Balance at December 31, 2016	60,781,858	\$ 608	\$ 102,098	\$ (93,863)	\$ (22)	\$ (15)	\$ 8,806

The accompanying notes are an integral part of these consolidated financial statements.

Mace Security International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2016 and 2015
(Amounts in thousands)

	<u>2016</u>	<u>2015</u>
Cash Flows from Operating activities:		
Net income (loss)	\$ 250	\$ (1,027)
Income (loss) from discontinued operations, net of tax	<u>351</u>	<u>(206)</u>
Loss from continuing operations	<u>(101)</u>	<u>(821)</u>
Adjustments to reconcile loss from continuing operations to net cash provided by (used in) operating activities:		
Depreciation	155	140
Stock-based compensation	194	165
Provision for losses on receivables	59	45
Provision for obsolete inventory	134	41
Loss on sale of property and equipment	3	29
Loss on sale of short-term investments	15	21
Gain on retirement of debt	-	(322)
Changes in operating assets and liabilities:		
Accounts receivable	(152)	(219)
Inventories	(101)	(313)
Prepaid expenses and other assets	(122)	231
Accounts payable	(28)	(259)
Accrued expenses and other liabilities	(173)	(266)
Income taxes payable	<u>(1)</u>	<u>1</u>
Net cash used in operating activities – continuing operations	<u>(118)</u>	<u>(1,527)</u>
Net cash provided by (used in) operating activities – discontinued	<u>331</u>	<u>(209)</u>
Net cash provided by (used in) operating activities	<u>213</u>	<u>(1,736)</u>
Cash Flows from Investing Activities:		
Purchase of property and equipment	(351)	(114)
Proceeds from sale of short-term investments	<u>362</u>	<u>3,686</u>
Net cash provided by investing activities-continuing operations	<u>11</u>	<u>3,572</u>
Net cash provided by investing activities-discontinued operations	<u>250</u>	<u>312</u>
Net cash provided by investing activities	<u>261</u>	<u>3,884</u>
Cash Flows from Financing Activities:		
Retirement of convertible debt	-	(2,297)
Proceeds from exercise of warrants	-	236
Proceeds from exercise of stock options	<u>50</u>	<u>-</u>
Net cash provided by (used in) financing activities – continuing	<u>50</u>	<u>(2,061)</u>
Net increase in cash, cash equivalents and restricted cash	524	87
Cash, cash equivalents, and restricted cash at beginning of year	<u>506</u>	<u>419</u>
Cash, cash equivalents, and restricted cash at end of year	<u>\$ 1,030</u>	<u>\$ 506</u>

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

NOTE 1 – DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

The accompanying consolidated financial statements include accounts of Mace Security International, Inc. and its wholly owned subsidiaries (collectively, the “Company”). All significant intercompany transactions have been eliminated in consolidation.

The Company currently operates in one business segment, the Security Segment, which sells consumer safety and personal defense products to retailers, distributors, and individual consumers. The Company also supplies less-lethal tactical munitions and weapons systems for law enforcement, correctional institutions and military markets. In December 2015, the Company exited the electronic surveillance equipment market (See Note 4).

In July 2012, the Company filed Form 15 with the United States Securities and Exchange Commission (“SEC”) to effectively terminate the Company’s registration and reporting as a public company under SEC rules and regulations.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Significant accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. The Company’s significant accounting policies are described below.

Revenue Recognition

The Company recognizes revenue in general when the following criteria have been met: persuasive evidence of an arrangement exists, a customer contract or purchase order exists and the price is fixed and determinable, no significant obligations remain and collection of the related receivable is reasonably assured. Revenues are recognized when products are shipped and title has passed. Allowances for sales returns, discounts and allowances are estimated and recorded concurrent with the recognition of revenue and are primarily based on historic experience and contractual obligations.

Cash and Cash Equivalents

The Company maintains its cash accounts in regulated financial institutions. The Company considers all highly liquid short-term investments with original maturities of three months or less to be cash equivalents. A substantial majority of the Company’s cash and cash equivalent balances exceeded insured amounts at December 31, 2016 and 2015.

Restricted Cash

The Company has cash in a restricted bank account. The restricted balance at December 31, 2016 and 2015 is related to a payment card agreement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

Short Term Investments and Marketable Securities

The Company holds a number of short-term investments. The investments are comprised of marketable equity securities, mutual funds and exchange-traded products. All short-term investments are classified as available for sale and are valued and presented on the Consolidated Balance Sheets at current market prices. Dividends and interest earned and gains and losses realized from the sale of investments are reported in Interest income and Loss on sale of short-term investments in the Consolidated Statements of Operations. Unrealized gains/losses resulting from the increase/decrease in the market value of the investments are reported in accumulated other comprehensive income/loss in the Consolidated Balance Sheets.

Accounts Receivable

The Company's accounts receivable are primarily due from trade customers. Credit is extended based on evaluation of customers' financial condition and, generally, collateral is not required. Customer credit terms vary. Amounts due from customers are stated in the financial statements net of an allowance for doubtful accounts. Accounts which are outstanding longer than the credit terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they are deemed uncollectible. Any payments subsequently received on such receivables are credited to the Consolidated Statements of Operations. International credit risk is managed by requiring substantially all international customers to provide payment in advance of shipment.

During fiscal 2016 and 2015, \$196 and \$19 of accounts receivable were written off against the allowance for doubtful accounts, respectively. Bad debt expense, net of recoveries, was \$59 and \$10 in fiscal 2016 and 2015, respectively.

Concentration of Significant Customers

The Company routinely assesses the financial strength of its customers. As a result, the Company believes that its accounts receivable credit risk exposure is limited and has not experienced significant write-offs of its accounts receivable balances. At December 31, 2016, 3 customers accounted for 20%, 20% and 19% of the net accounts receivable balance. At December 31, 2015, two customers accounted for 36% and 16% of net accounts receivable balance. During the year ended December 31, 2016, one customer accounted for 14% of the Company's net revenue. During the year ended December 31, 2015, one customer accounted for 14% and another for 13% of the Company's net revenue.

Inventories

Inventories are stated at the lower of cost or net realizable value. Cost is determined using the first-in first-out (FIFO) method. Inventories consist of defense sprays, and various other consumer security and safety products. The Company periodically reviews the book value of slow moving inventory items, as well as discontinued product lines, to determine if inventory is properly valued. The Company identifies slow moving or discontinued product lines by a detail review of recent sales volumes of inventory items as well as a review of recent selling prices versus cost and assesses the ability to dispose of inventory items at a price greater than cost. If market value is less than cost, then an adjustment is made to adjust the inventory to market value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

At December 31, 2015, the Company's electronic surveillance equipment inventories, consisting of electronic security monitors, cameras and digital recorders, were reported in assets held for sale net of associated reserves as a result of the Company's December 2015 decision to exit the electronic surveillance equipment business. This inventory was sold in November 2016. See Note 4, Business Divestitures, Assets Held for Sale and Discontinued Operations.

Property and Equipment

The Company leases all of its facilities. Property and equipment are stated at cost. Depreciation is recognized using the straight-line method over the estimated useful lives of the assets, which are generally as follows: leasehold improvements - 8 to 10 years; machinery and equipment - 3 to 10 years; and furniture and fixtures - 3 to 10 years. Significant additions or improvements extending assets' useful lives or their capabilities are capitalized; normal maintenance and repair costs are expensed as incurred. Depreciation expense from continuing operations was approximately \$155 and \$140 for the years ended December 31, 2016 and 2015, respectively. Maintenance and repairs are charged to expense as incurred and amounted to approximately \$37 and \$20 for the years ended December 31, 2016 and 2015, respectively.

Impairment of Long-Lived Assets

The Company periodically reviews the carrying value of its (i) long-lived assets held and used and (ii) assets to be disposed of when events and circumstances warrant such a review. If significant events or changes in circumstances indicate that the carrying value of an asset or asset group may not be recoverable, the Company performs a test of recoverability by comparing the carrying value of the asset or asset group to its undiscounted expected future cash flows. Cash flow projections are sometimes based on a group of assets, rather than a single asset. If cash flows cannot be separately and independently identified for a single asset, the Company determines whether impairment has occurred for the group of assets for which it can identify the projected cash flows. If the carrying values are in excess of undiscounted expected future cash flows, the Company measures any impairment by comparing the fair value of the asset group to its carrying value. If the fair value of an asset or asset group is determined to be less than the carrying amount of the asset or asset group, impairment in the amount of the difference is recorded.

Other Intangible Assets

Other intangible assets consist primarily of trademarks. The trademarks are considered to have indefinite lives, and as such, are not subject to amortization. These assets are tested for impairment using a discounted cash flow methodology annually and whenever there is an impairment indicator. Estimating future cash flows requires significant judgment and projections may vary from cash flows eventually realized. Several impairment indicators are beyond the Company's control, and determining whether or not they will occur cannot be predicted with any certainty.

Income Taxes

Deferred income taxes are determined based on the difference between the financial accounting and tax basis 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. In establishing the provision for income taxes and deferred income tax assets and liabilities, and valuation allowances against deferred tax assets, the Company makes judgments and interpretations based on enacted laws, published tax guidance and estimates of future earnings. Deferred income tax assets include tax loss and credit carryforwards and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

are reduced by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred income tax assets will not be realized.

Advertising and Marketing Costs

The Company expenses advertising costs, including advertising production cost, as the costs are incurred. Advertising expense from continuing operations was approximately \$115 and \$278 for the years ended December 31, 2016 and 2015, respectively.

Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash and cash equivalents, short-term investments, trade receivables, notes receivable, trade payables and debt instruments. The carrying values of the Company's financial instruments are considered to be representative of their respective fair values.

In accordance with the Accounting Standards Codification ("ASC") 820, "Fair Value Measurement and Disclosures", a hierarchy is established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring the fair value. The hierarchy defines three levels of inputs that may be used to measure fair value:

Level 1 – Unadjusted quoted prices in active markets for identical unrestricted assets and liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 – Inputs other than the quoted prices included within Level 1 that are observable for the asset and liability or can be corroborated with observable market data for substantially the entire contractual term of the asset or liability.

Level 3 – Unobservable inputs that reflect the entity's own assumptions about the assumptions market participants would use in the pricing of an asset or liability and are consequently not based on market activity but rather through particular valuation techniques. The fair value of the Company's notes receivable is determined by calculating the expected amount of cash to be received. Given the relative short-term nature of the notes receivable, discount rate and prepayments were not factors in determining the fair value of the notes receivable. See Note 4, Business Divestitures, Assets Held for Sale and Discontinued Operations for additional information regarding the notes receivable.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

The following tables summarize the Company's short term investments and notes receivable recorded at fair value by fair value hierarchy levels as of December 31, 2016 and 2015:

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Short-term investments	\$ 1,794	\$ -	\$ -	\$ 1,794
Notes receivable	-	-	1,466	1,466
	<u>\$ 1,794</u>	<u>\$ -</u>	<u>\$ 1,466</u>	<u>\$ 3,260</u>

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
Short-term investments	\$ 2,142	\$ -	\$ -	\$ 2,142
Notes receivable	-	-	1,266	1,266
	<u>\$ 2,142</u>	<u>\$ -</u>	<u>\$ 1,266</u>	<u>\$ 3,408</u>

The following table summarizes the changes in fair value measurements using Level 3 inputs for the years ended December 31, 2016 and 2015:

	Year ended December 31,	
	2016	2015
Balance at January 1	\$ 1,266	\$ 1,578
Payments	(250)	(312)
Increase in notes receivable	450	-
Balance at December 31	<u>\$ 1,466</u>	<u>\$ 1,266</u>

Impact of Newly Issued Accounting Standards

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". This new standard provides a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers, which supersedes most current revenue recognition guidance. This new revenue recognition model requires entities to conduct a five-step analysis to determine when and how revenue is recognized. The new model requires revenue recognition to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. This standard is effective for the Company beginning in fiscal 2019 and allows for either full retrospective adoption or modified retrospective adoption. The Company does not expect that the adoption of this standard will have a material effect on its consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, “Disclosures of Uncertainties about an Entity’s Ability to Continue as a Going Concern”. This standard requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Certain disclosures will be required if conditions give rise to substantial doubt about an entity’s ability to continue as a going concern. This standard applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The adoption of this standard did not have a material impact on the Company’s consolidated financial statements.

In July 2015, the FASB issued Accounting Standards Update No. 2015-11: “Simplifying the Measurement of Inventory”, which applies to inventory that is measured using first-in, first-out or average cost. As proscribed in this update, an entity should measure inventory that is within scope at the lower of cost and net realizable value, which is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. This update is effective for annual and interim reporting periods beginning after December 15, 2016, and should be applied prospectively, with early adoption permitted at the beginning of an interim or annual reporting period. The Company does not expect that the adoption of this standard will have a material effect on its consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02: “Leases”. Under this standard, an entity will be required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. This standard offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. This standard is effective for annual reporting periods beginning after December 15, 2018 and requires a modified retrospective adoption, with early adoption permitted. The Company is assessing the impact adopting this new accounting guidance will have on its consolidated financial statements and disclosures.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09: “Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. This accounting standard update will directly impact the tax administration of equity plans. The standard is effective for fiscal years beginning after December 15, 2016, including interim periods with those fiscal years. Early adoption is permitted and any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The Company does not expect that the adoption of this standard will have a material effect on its consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13: “Financial Instruments – Credit Losses”. This new standard requires trade accounts receivable to be presented at the net amount expected to be collected. The standard eliminates the probable initial recognition threshold in current accounting standards and, instead, requires an entity’s current estimates of all expected credit losses. The standard is effective for fiscal years beginning after December 15, 2019. The Company does not expect that the adoption of this standard will have a material effect on its consolidated financial statements.

No other new accounting pronouncement had or is expected to have a material impact on the Company’s Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

Net Income per Share

The Company's net income (loss) per basic share has been computed based on the weighted-average number of common shares outstanding. The Company calculates diluted earnings per share based upon the weighted-average number of shares outstanding plus the dilutive effect of share equivalents calculated using the treasury stock method.

The dilutive effect of the Company's stock options was as follows:

	For the year ended	
	December 31,	
	<u>2016</u>	<u>2015</u>
Weighted-average shares outstanding - basic	60,498,053	59,197,128
Dilutive effect of stock options	946,377	873,362
Weighted-average shares outstanding - diluted	<u>61,444,430</u>	<u>60,070,490</u>

Outstanding stock options relating to approximately 1,682,373 and 2,068,977 weighted-average shares were excluded from the calculation of diluted earnings per share for the year ended December 31, 2016 and 2015, respectively, as the impact of including such stock options in the calculation of diluted earnings per share would have an anti-dilutive effect.

Reclassifications

Certain reclassifications have been made to the 2015 consolidated financial statements to conform to the 2016 consolidated financial statement presentation. Such reclassifications had no effect on net loss as previously reported.

NOTE 3 - SUPPLEMENTARY CASH FLOW INFORMATION

Interest paid on all indebtedness, including discontinued operations, was approximately \$50 and \$80 for the years ended December 31, 2016 and 2015, respectively.

Income taxes paid totaled approximately \$2 and \$1 in the years ended December 31, 2016 and 2015, respectively.

NOTE 4 – BUSINESS DIVESTITURES, ASSETS HELD FOR SALE, AND DISCONTINUED OPERATIONS

Wholesale Security Monitoring Services Business

On December 17, 2013, the Company completed the sale of its wholesale security monitoring services business, excluding cash, accounts receivable, certain prepaid expenses and most liabilities, to Security Partners, LLC, based in Pennsylvania. The Company received cash proceeds, net of customary transaction fees, of \$4,711 and two notes receivable (\$1,497 (“Note 1”) and \$250 (“Note 2”)) totaling \$1,747. The transaction resulted in a pre-tax gain of \$2,340 in fiscal 2013.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

Under the asset purchase agreement, the purchase price for the business was adjusted for revisions to dealer contract values during the second quarter of fiscal 2014. As a result of this adjustment, the purchase price was increased by \$430, resulting in an additional pretax gain of \$409, net of customary transaction fees. The Company received additional net cash proceeds of \$315 and the balance of the adjustment to the purchase price was added to Note 1, resulting in a principal balance of \$1,591.

In October 2014, the Company renegotiated Note 1. The principal amount was reduced \$100 to \$1,491, the interest rate increased to 5.5% and the repayment term extended to 30 monthly periods commencing July 10, 2014.

In April 2015, the Company amended Note 1 reducing the monthly principal repayment amount for the period April to September 2015 by \$10 per month and providing for the repayment of the deferred principal in a lump sum payment due on May 10, 2017.

In January 2016, the Company amended Note 1 providing for the deferral of interest and principal payments from August 11, 2015 to no later than March 10, 2016. Thereafter regular monthly interest and principal payments resume. The amendment further provides for the payment of interest accrued during the deferral period by no later than March 10, 2016 and extends the due date of the note to December 10, 2017. The deferred interest was paid in July 2016.

In July 2016, the Company amended Note 1 providing for interest only payments commencing August 10, 2016 and the resumption of principal and interest payments on January 10, 2017 and the extension of the maturity date of Note 1 to December 10, 2019.

In January 2017, the Company amended Note 1 providing for interest only payments commencing February 10, 2017 and the resumption of principal and interest payments on August 10, 2017.

In January 2016, the Company amended Note 2 providing for the deferral of interest payments from August 18, 2015 to no later than March 17, 2016. Thereafter regular monthly interest payments resume. The amendment provides for the payment of interest accrued during the deferral period by no later than March 17, 2016. Note 2 was fully paid off, including accrued interest, in July 2016.

At December 31, 2016, the current portion of the notes receivable of \$158 is in Prepaid Expenses and Other Current Assets, while the non-current portion of \$858 is in Other Assets on the Consolidated Balance Sheets.

Electronic Surveillance Equipment Business

In November 2016, the Company completed the sale of its electronic surveillance equipment business, consisting of inventory and a customer list. The Company received a \$450 note receivable that is due January 20, 2020. The transaction resulted in a pre-tax gain of \$212 in fiscal 2016. At December 31, 2016, the current portion of the note receivable of \$128 is in Prepaid Expenses and Other Current Assets, while the non-current portion of \$322 is in Other Assets on the Consolidated Balance Sheets. At December 31, 2015, electronic surveillance equipment inventory held for sale was \$430.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

Discontinued Operations

The financial results of the electronic surveillance equipment business and wholesale security monitoring services business included in discontinued operations were as follows:

	Year ended December 31,	
	2016	2015
Net sales	\$ 630	\$ 1,214
Cost of goods sold	413	861
Selling, general, and administrative expenses	78	550
Depreciation	-	8
Operating income (loss)	<u>139</u>	<u>(205)</u>
Other income	212	-
Income (loss) before income tax provision	<u>351</u>	<u>(205)</u>
Provision for income tax on operations	-	1
Income (loss) from operations, net of tax	<u>\$ 351</u>	<u>\$ (206)</u>
Income (loss) from discontinued operations, net of tax	<u>\$ 351</u>	<u>\$ (206)</u>

Discontinued operations are expected to generate cash flows through the last maturity date of the notes receivable in 2020.

NOTE 5 – ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table shows the beginning balance, annual activity and ending balance of accumulated other comprehensive loss, all of which pertains to the Company's short-term investments.

Balance at December 31, 2014	\$ (45)
Changes in value (net of tax effect of \$0)	(20)
Reclassification into earnings (net of tax effect of \$0)	<u>21</u>
Balance at December 31, 2015	(44)
Changes in value (net of tax effect of \$0)	7
Reclassification into earnings (net of tax effect of \$0)	<u>22</u>
Balance at December 31, 2016	<u>\$ (15)</u>

Amounts reclassified for investments are recorded in loss on sale of short-term investments in the Consolidated Statements of Operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(Amounts in thousands, except share and per share amounts)

NOTE 6 – OTHER INTANGIBLE ASSETS

Other intangible assets consist of:

	<u>December 31, 2016</u>		<u>December 31, 2015</u>	
	<u>Gross</u>	<u>Accumulated</u>	<u>Gross</u>	<u>Accumulated</u>
	<u>Carrying</u>	<u>Amortization</u>	<u>Carrying</u>	<u>Amortization</u>
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>
Non-amortized trademarks	<u>\$ 685</u>	<u>\$ -</u>	<u>\$ 685</u>	<u>\$ -</u>

The Company annually performs impairment testing of its intangible assets, consisting primarily of the Company’s trademarks. The most recent evaluation was performed as of December 31, 2016. As a result of this evaluation, it was determined that there was no impairment of the Company’s intangible assets as of December 31, 2016.

NOTE 7 – INVENTORIES

Inventories consist of the following:

	<u>For the year ended</u>	
	<u>December 31,</u>	
	<u>2016</u>	<u>2015</u>
Raw materials	<u>\$ 760</u>	<u>\$ 611</u>
Finished goods	<u>808</u>	<u>990</u>
Total inventories	<u>\$ 1,568</u>	<u>\$ 1,601</u>

All of the electronic surveillance equipment inventories held for sale consisted of finished goods at December 31, 2015.

NOTE 8 – LONG-TERM DEBT

At December 31, 2016 and 2015, the Company has no long-term debt.

On January 13, 2015, the Company repaid its convertible \$1,400 note with a payment of \$2,297 to Merlin Partners, LP pursuant to an agreement entered into on December 24, 2014. The Company recognized a gain of \$322 in 2015 in conjunction with this repayment in Other Income in the Consolidated Statements of Operations. This repayment is at a significant discount to the convertible note conversion value, and a premium to its face value. The repayment of the convertible note eliminated the potential issuance of approximately 7,291,666 shares of Mace common stock.

Concurrent with repaying its convertible \$1,400 Merlin note in January 2015, the Company entered into a Put Option Agreement (“Put Option”), expiring January 17, 2017, with several investors requiring the investors to make loans to the Company in the aggregate amount of \$2,000 at the Company’s discretion.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

The Company is obligated to pay a 5% purchase price for the Put Option. \$50 of the Put Option purchase price was paid in January 2015, and the remainder was due February 15, 2016. See Note 14, Related Party Transactions, for additional information regarding the Put Option.

NOTE 9 – ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

	December 31,	
	2016	2015
Accrued employee compensation	\$ 152	\$ 224
Co-operative advertising and other sales allowances	217	363
Accrued commissions	21	27
Amounts due to customers	40	3
Accrued non-income based taxes	11	22
Accrued for vendor financed property and equipment	41	-
Other	36	56
	<hr/>	<hr/>
Total accrued expenses and other current liabilities	\$ 518	\$ 695

NOTE 10 – STOCK-BASED COMPENSATION

The Company's stock option plans are administered by the Compensation Committee (the "Committee") of the Board of Directors.

In December 1999, the Company's stockholders approved the 1999 Stock Option Plan (the "1999 Plan") providing for the granting of incentive stock options or nonqualified stock options to directors, officers, or employees of the Company. Under the 1999 Plan, 7,500,000 shares of common stock are reserved for issuance. Incentive stock options and nonqualified options have terms which are determined by the Committee with exercise prices not less than the market value of the shares on the date of grant. The options generally expire five to ten years from the date of grant and are exercisable based upon graduated vesting schedules as determined by the Committee. The Plan terminated March 26, 2009. No further options may be awarded under the 1999 plan.

In June 2012, the Company adopted, with shareholder approval, the 2012 Stock Option Plan (the "2012 Plan"). The 2012 Plan provides for the granting of incentive stock options or nonqualified stock options to directors, officers, employees or vendors of the Company. Under the 2012 Plan, 15,000,000 shares of common stock are reserved for issuance. Incentive stock options and nonqualified options have terms which are determined by the Committee, with exercise prices not less than the market value of the shares on the date of grant. The options generally expire five to ten years from the date of grant and are either exercisable immediately or exercisable based upon graduated vesting schedules as determined by the Committee.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

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As of December 31, 2016, 7,056,596 nonqualified stock options were outstanding under the 1999 and 2012 Plans. Newly issued shares or, to the extent possible, shares of treasury stock are used to satisfy requirements resulting from the exercise of stock options.

Activity with respect to these plans is as follows:

	<u>2016</u>		<u>2015</u>	
	<u>Number</u>	<u>Weighted Average Exercise Price</u>	<u>Number</u>	<u>Weighted Average Exercise Price</u>
Options outstanding beginning of period	6,730,886	\$ 0.58	6,448,603	\$ 0.62
Options granted	903,377	\$ 0.40	661,834	\$ 0.39
Options exercised	(300,000)	\$ 0.16	-	\$ -
Options forfeited	-	-	(259,550)	\$ 0.35
Options expired	(277,667)	\$ 2.42	(120,001)	\$ 2.10
Options outstanding end of period	<u>7,056,596</u>	<u>\$ 0.50</u>	<u>6,730,886</u>	<u>\$ 0.58</u>
Options exercisable	<u>5,923,696</u>	<u>\$ 0.53</u>	<u>5,458,298</u>	<u>\$ 0.72</u>
Shares available for granting of options	<u>9,183,739</u>		<u>10,087,116</u>	

The Company recognizes compensation expense for all share-based awards on a straight-line basis over the vesting period of the instruments, based upon the grant date fair value of the stock options issued. Total stock compensation expense was \$194 and \$165 for the years ended December 31, 2016 and 2015, respectively. No tax benefit was recognized for this compensation expense. At December 31, 2016, total unrecognized stock-based compensation expense is \$207, which has a weighted average period to be recognized of approximately 2.3 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Expected term - The Company's expected term is based on the period the options are expected to remain outstanding. The Company estimated this amount based on historical experience of similar awards, giving consideration to the contractual terms of the awards, vesting requirements and expectations of future behavior.

Risk-free interest rate - The Company uses the risk-free interest rate of a U.S. Treasury Note with a similar term on the date of the grant.

Volatility - The Company calculates the volatility of the stock price based on historical value and corresponding volatility of the Company's stock price over the prior five years.

Dividend yield - The Company uses a 0% expected dividend yield, as the Company does not have a history of paying dividends and does not anticipate declaring dividends in the near future.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

NOTE 11 – INCOME TAXES

A reconciliation of income taxes computed at the U.S. federal statutory tax rates to total income tax provision applicable to continuing operations expense is as follows:

	<u>Year Ended December 31,</u>	
	<u>2016</u>	<u>2015</u>
Tax at U.S. federal statutory rate	\$ (41)	\$ (279)
State taxes, net of federal benefit	(13)	173
Permanent items	(17)	(258)
Expiration of capital loss carryover	-	2,371
Exercise of stock options	(23)	-
Other	(16)	58
Increase (decrease) in valuation allowance	91	(2,064)
	<u>\$ (19)</u>	<u>\$ 1</u>
Total income tax provision (benefit)	<u>\$ (19)</u>	<u>\$ 1</u>

The components of income tax provision (benefit) from continuing operations are:

	<u>Year Ended December 31,</u>	
	<u>2016</u>	<u>2015</u>
Current income tax provision (benefit)		
U.S. state and local	<u>\$ (19)</u>	<u>\$ 1</u>
Total current tax provision (benefit)	(19)	1
Deferred income tax provision (benefit)	-	-
Total income tax provision (benefit)	<u>\$ (19)</u>	<u>\$ 1</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities at December 31, 2016 and 2015 are as follows:

	December 31,	
	2016	2015
Deferred tax assets:		
Allowance for doubtful accounts	\$ 42	\$ 93
Inventories	224	235
Net operating and capital loss carryforwards	22,208	22,159
Vesting stock options	814	760
Other, net	148	143
Total deferred tax assets	<u>23,436</u>	<u>23,390</u>
Valuation allowance for deferred tax assets	<u>(23,092)</u>	<u>(23,120)</u>
Deferred tax asset after valuation allowance	344	270
Deferred tax liabilities:		
Property, equipment and intangibles	<u>(344)</u>	<u>(270)</u>
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>

At December 31, 2016, the Company had U.S. federal net operating loss carryforwards (“NOLs”) of approximately \$60,023 expiring in 2018 through 2036.

Realization of the future tax benefits related to the deferred tax assets is dependent upon many factors, including the Company's ability to generate taxable income in future years. The Company performed a detailed review of the considerations influencing its ability to realize the future benefit of the NOLs, including the extent of recently used NOLs, the turnaround of future deductible temporary differences, the duration of the NOL carryforward period, and the Company's future projection of taxable income. Utilization of the Company's net operating loss and tax credit carryforwards may be subject to annual limitations due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss or tax credits before utilization. The Company decreased its total valuation allowance against deferred tax assets by \$28 in 2016 resulting in a total valuation allowance of \$23,092 at December 31, 2016, representing the amount of its deferred income tax assets in excess of the Company's deferred income tax liabilities. The valuation allowance was recorded because the Company's management was unable to conclude that realization of the net deferred income tax asset was more likely than not. This determination was a result of the Company's continued operating losses in its fiscal year ended December 31, 2016, and the uncertainty of and the ultimate extent of growth in the Company's business.

The Company follows the appropriate accounting pronouncements which prescribe a model for the recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on recognition, classification, interest and penalties, disclosure and transition. At December 31, 2016 and 2015, the Company did not have any significant unrecognized tax benefits. The total amount of interest and penalties recognized in the Consolidated Statements of Operations for the years ended December 31, 2016 and 2015 was insignificant and when incurred is reported as interest or penalties expense, as applicable.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

(Amounts in thousands, except share and per share amounts)

The Company is subject to income taxes in the U.S. federal jurisdiction, and various state and local jurisdictions. The Company believes it has appropriate support for its federal income tax returns. The Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for fiscal years prior to 2012.

NOTE 12 – DEFINED CONTRIBUTION PLAN

Substantially all employees of the Company are eligible to participate in the Company’s defined contribution plan. The Company currently is not making any matching contributions to the plan.

NOTE 13 – COMMITMENTS AND CONTINGENCIES

The Company leases buildings and equipment under non-cancelable operating lease agreements expiring at various dates through 2023. Total rent expense was \$243 and \$253 for the years ended December 31, 2016 and 2015, respectively.

At December 31, 2016, future minimum lease commitments are as follows:

2017	\$ 214
2018	223
2019	232
2020	232
2021	232
2022 and thereafter	<u>344</u>
Total	<u>\$ 1,477</u>

In the normal course of business, the Company may be involved in ordinary, routine legal actions. The Company cannot reasonably estimate future costs, if any, related to these matters; however, it does not believe any such matters are material to its financial condition or results of operations. The Company maintains various liability insurance policies to protect its assets from losses arising out of or involving activities associated with ongoing and normal business operations; however, it is possible that the Company’s future operating results could be affected by future costs of litigation.

NOTE 14 – RELATED PARTY TRANSACTIONS

The Company borrowed \$1.35 million from Merlin Partners, LP (“Merlin”) in 2010. Merlin is a fund managed by Ancora Advisors LLC, and an entity within the Ancora Group. Richard A. Barone, a Company Director, is a portfolio manager and an owner of Ancora Advisors LLC. Denis J. Amato, a Company Director, is a portfolio manager and an owner of Ancora Advisors LLC. As part of the consideration for the financing, Merlin was issued a warrant to purchase 314,715 shares of the Company’s common stock at an exercise price of \$0.20 per share, expiring on December 28, 2015. The warrant contained an anti-dilution provision. On August 2, 2011, upon conclusion of the Company’s Stock Rights Offering, and on December 24, 2015, warrants for 847,452 and 16,762 shares, respectively, expiring on December 28, 2015, were issued to Merlin under the anti-dilution provision. This loan was repaid in 2011 and 1,178,929 warrants were exercised in 2015.

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On March 30, 2011, the Company borrowed \$1,400 with an interest rate of 6% per annum from Merlin to fund the acquisition of TCCI, a wholesale security monitoring company. This convertible note was repaid in January 2015. See Note 8 – Long-Term Debt. As compensation for the \$1,400 convertible note, Merlin received a five year warrant exercisable into 157,357 shares of common stock at an exercise price of \$0.20 per share, expiring on March 30, 2016. The warrant contained an anti-dilution provision that provided that the Company would issue Merlin a warrant equal to 1% percent of any shares issued by the Company for one year after the date the warrant was issued. Any new warrant issued would be exercisable at \$0.20 cents per share. On August 2, 2011, after the completion of the Company’s Rights Offering, and on December 24, 2015, warrants for 423,726 and 8,381 shares, respectively, expiring on March 30, 2016, were issued to Merlin under the anti-dilution provision. The initial warrants were accounted for at a Black-Scholes fair value of the warrant of \$47 recorded as a discount to the \$1,400 convertible note and as additional paid-in capital. The discount was accreted as a charge to interest expense over the maturity period of the convertible note with an offsetting credit to the loan balance. Merlin Partners, LP did a cashless exercise of all 589,464 of these warrants in 2016 resulting in the issuance of 196,488 shares of the Company’s stock.

Concurrent with repaying its convertible \$1,400 Merlin note in January 2015, the Company entered into a Put Option Agreement (“Put Option”), expiring January 17, 2017 with several investors requiring the investors to make loans to the Company in the aggregate amount of \$2,000 at the Company’s discretion. The Company is obligated to pay a 5% purchase price for the Put Option. \$50 of the Put Option purchase price was paid in January 2015, and the remainder was due February 15, 2016. The Put Option investors and their respective share of the Put Option are as follows:

<u>Investor</u>	<u>Percentage</u>
Richard A. Barone – Company Director	50.0 %
Denis J. Amato – Company Director	15.0
Diamond A Partners, L.P. – a shareholder of the Company	21.1
Independent investor (unrelated party)	5.0
John J. McCann – Chief Executive Officer and Company Director	2.6
Fred Di Santo – Chairman and Chief Executive Officer of The Ancora Group	2.5
Diamond A Investors, L.P. – a shareholder of the Company	3.8
	100.0 %

NOTE 15 – SUBSEQUENT EVENTS

The Company evaluated its December 31, 2016 financial statements for subsequent events through February 21, 2017, the date the financial statements were available to be issued. The Company is not aware of any subsequent events, other than as discussed in Note 4, Business Divestitures, Assets Held for Sale, and Discontinued Operations, which would require recognition or disclosure in the consolidated financial statements.