

Consolidated Financial Statements

**Mace Security International, Inc.**

March 31, 2014 and 2013

# Contents

	<u>Page</u>
Consolidated Balance Sheets	2
Consolidated Statements of Operations	3
Consolidated Statements of Comprehensive Loss	4
Consolidated Statements of Cash Flows	5
Notes to Unaudited Consolidated Financial Statements	6-13

Mace Security International, Inc. and Subsidiaries

**CONSOLIDATED BALANCE SHEETS**

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

ASSETS	March 31, 2014 <u>(Unaudited)</u>	December 31, 2013 <u></u>
Current assets:		
Cash and cash equivalents	\$ 1,038	\$ 4,923
Restricted cash	275	127
Short-term investments	5,875	2,597
Accounts receivable, less allowance for doubtful accounts of \$478 at both March 31, 2014 and December 31, 2013	1,211	1,732
Inventories, less reserve for obsolescence of \$188 and \$209, respectively	1,823	1,578
Prepaid expenses and other current assets	<u>1,316</u>	<u>1,419</u>
Total current assets	11,538	12,376
Property and equipment:		
Buildings and leasehold improvements	235	168
Machinery and equipment	2,040	2,027
Furniture and fixtures	<u>467</u>	<u>462</u>
Total property and equipment	2,742	2,657
Accumulated depreciation and amortization	<u>(2,136)</u>	<u>(2,092)</u>
Total property and equipment, net	606	565
Other intangible assets	685	685
Other assets	<u>984</u>	<u>1,148</u>
Total assets	<u>\$ 13,813</u>	<u>\$ 14,774</u>

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

<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>March 31, 2014</b>	<b>December 31, 2013</b>
	<b>(Unaudited)</b>	
Current liabilities:		
Accounts payable	\$ 397	\$ 392
Income taxes payable	61	62
Accrued expenses and other current liabilities	863	1,086
	<u>1,321</u>	<u>1,540</u>
Long-term debt, net of current portion	1,138	1,106
Other liabilities	231	230
Stockholders' equity:		
Preferred stock, \$.01 par value; authorized 10,000,000 shares, no shares issued and outstanding at March 31, 2014 and December 31, 2013	-	-
Common stock, \$.01 par value; authorized 100,000,000 shares, issued and outstanding shares of 58,946,441, respectively	589	589
Additional paid-in capital	102,714	102,628
Accumulated deficit	(92,176)	(91,382)
Accumulated other comprehensive loss	17	84
	<u>11,144</u>	<u>11,919</u>
Less treasury stock at cost 18,332 and 218,332 shares , respectively	(21)	(21)
	<u>11,123</u>	<u>11,898</u>
Total liabilities and stockholders' equity	<u>\$ 13,813</u>	<u>\$ 14,774</u>

Mace Security International, Inc. and Subsidiaries

**CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

(Amounts in thousands)

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Net sales	1,682	2,192
Cost of goods sold	<u>1,119</u>	<u>1,211</u>
Gross profit	563	981
Selling, general, and administrative expenses	1,405	1,460
Depreciation and amortization	<u>44</u>	<u>38</u>
Operating loss	(886)	(517)
Interest expense	(55)	(60)
Interest income	47	13
Other income	<u>104</u>	<u>-</u>
Loss from continuing operations before income tax provision	(790)	(564)
Income tax provision	<u>1</u>	<u>-</u>
Loss from continuing operations	(791)	(564)
Loss from discontinued operations, net of tax of \$0	<u>(3)</u>	<u>(85)</u>
Net loss	<u><u>(794)</u></u>	<u><u>(649)</u></u>

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

Mace Security International, Inc. and Subsidiaries

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

(Unaudited)

(Amounts in thousands)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2014</b>	<b>2013</b>
Net loss	\$ (794)	\$ (649)
Other comprehensive income (loss): unrealized loss on short-term	(67)	18
Total comprehensive loss	<u>\$ (861)</u>	<u>\$ (631)</u>

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

Mace Security International, Inc. and Subsidiaries

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(Amounts in thousands)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2014</b>	<b>2013</b>
	<hr/>	<hr/>
<b>Cash Flows from Operating activities:</b>		
Net loss	\$ (794)	\$ (649)
Loss from discontinued operations, net of tax	3	85
Loss from continuing operations	<hr/> (791)	<hr/> (564)
Adjustments to reconcile loss from continuing operations to net cash used in operating activities:		
Depreciation and amortization	44	38
Stock-based compensation	86	13
Provision for losses on receivables	11	15
Loss on sale of property and equipment	-	2
Amortization of discount on debt	32	35
Changes in operating assets and liabilities:		
Accounts receivable	511	(283)
Inventories	(245)	181
Prepaid expenses and other assets	267	961
Accounts payable	4	(380)
Accrued expenses and other current liabilities	(221)	(97)
Income taxes payable	(1)	(10)
Net cash used in operating activities – continuing operations	<hr/> (303)	<hr/> (89)
Net cash provided by (used in) operating activities – discontinued operations	(3)	32
Net cash used in operating activities	<hr/> (306)	<hr/> (57)
<b>Cash Flows from Investing Activities:</b>		
Purchase of property and equipment	(84)	(18)
Purchase of short-term investments, net	(3,346)	(117)
Other	-	(1)
Net cash used in investing activities-continuing operations	<hr/> (3,430)	<hr/> (136)
Net cash used in investing activities-discontinued operations	-	(12)
Net cash used in investing activities	<hr/> (3,430)	<hr/> (148)
<b>Cash Flows from Financing Activities:</b>		
Increase in restricted cash	(149)	-
Net cash used in financing activities – continuing operations	<hr/> (149)	<hr/> -
Net cash used in financing activities – discontinued operations	-	(17)
Net cash used in financing activities	<hr/> (149)	<hr/> (17)
Net decrease in cash and cash equivalents	(3,885)	(222)
Cash and cash equivalents at beginning of period	4,923	2,065
Cash and cash equivalents at end of period	<hr/> <b>\$ 1,038</b> <hr/>	<hr/> <b>\$ 1,843</b> <hr/>

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

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

March 31, 2014 and 2013

(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 consists of Mace Personal Defense & Security Inc., which sells consumer safety, personal defense, and electronic surveillance equipment and products. In December 2013, the Company sold its wholesale security monitoring business that was conducted by the Company’s Mace CSSS, Inc. subsidiary.

The Company also had a Car Wash Segment which provided complete car care services (including car wash, detailing, lube, and minor repairs). The Car Wash Segment ceased operations in August 2012. See Note 5, Business Divestitures, Assets Held for Sale and Discontinued Operations.

These unaudited consolidated financial statements should be read in conjunction with the Company’s December 31, 2013 Consolidated Financial Statements. The results of operations for any interim period are not necessarily indicative of the results to be expected for other interim periods or the full year.

**NOTE 2 – IMPACT OF NEWLY ISSUED ACCOUNTING STANDARDS**

In April 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-8, “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity” to modify the requirements for reporting a discontinued operation. The amended definition of “discontinued operations” includes only disposals or held-for-sale classifications of components or groups of components of an entity that represent a strategic shift that either has or will have a major effect on the entity’s operations and financial results. This new guidance also expands the disclosure requirements required when an entity reports a discontinued operation or when it disposed of or classifies as held for sale an individually significant component that does not meet the definition of a discontinued operation. This new guidance is effective prospectively for all disposals or classifications as held for sale that occur after December 31, 2014. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

**NOTE 3 - RECLASSIFICATIONS**

Certain prior period amounts have been reclassified to conform to the current period presentation.

**NOTE 4 - SUPPLEMENTARY CASH FLOW INFORMATION**

Interest paid on all indebtedness, including discontinued operations, was approximately \$21 and \$30 for the three month ended March 31, 2014 and 2013, respectively.

Income taxes paid totaled approximately \$1 and \$10 in the three months ended March 31, 2014 and 2013, respectively.



**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

March 31, 2014 and 2013

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

**NOTE 5 – BUSINESS DIVESTITURES, ASSETS HELD FOR SALE, AND DISCONTINUED OPERATIONS**

**Car Wash Segment**

In 2006, the Company began the divestiture of its Car Wash Segment. By September 2011, all but three of the Company’s car wash facilities were sold. The Car Wash Segment ceased operations in August 2012. In October 2013, the Company sold its last remaining car wash facility in Arlington.

**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 \$5,058 and two notes receivable totaling \$1,747. At March 31, 2014, the current portion of the notes receivable of \$934 is in Prepaid Expenses and Other Current Assets, while the non-current portion of \$813 is in Other Assets on the Consolidated Balance Sheets. The transaction resulted in a pre-tax gain of \$2,340 in fiscal 2013. Under the agreement, the purchase price for the business may be adjusted for revisions to dealer contract values through the period ending six months after the closing date.

There were no assets or liabilities held for sale at March 31, 2014 and December 31, 2013.

**Discontinued Operations**

The financial results of the wholesale security monitoring services business and the results for the car wash operations included in discontinued operations were as follows:

	<b>Three months ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Net sales	\$ -	\$ 1,053
Loss before income tax provision	(3)	(85)
Provision for income tax on operations	-	-
Loss from discontinued operations net of tax	<u>\$ (3)</u>	<u>\$ (85)</u>

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014 and 2013

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

## NOTE 6 – OTHER INTANGIBLE ASSETS

Other intangible assets consist of:

Useful Lives	March 31, 2014		December 31, 2013	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Non-amortized intangible assets	\$ 685	\$ -	\$ 685	\$ -

The Company annually performs impairment testing of its intangible assets, consisting primarily of the Company's trade name.

Other intangible asset amortization expense was \$0 and \$28 for the three months ended March 31, 2014 and 2013, respectively.

## NOTE 7 – INVENTORIES

Inventories, net of reserves for obsolete inventory, consist of the following:

	March 31, 2014	December 31, 2013
Finished goods	\$ 768	\$ 711
Raw materials	1,055	867
Total inventories	\$ 1,823	\$ 1,578

## NOTE 8 – LONG-TERM DEBT

Long-term debt consists of the following:

	March 31, 2014	December 31, 2013
Debenture note payable to Merlin Partners, LP	\$ 1,138	\$ 1,106

The Company had outstanding letters of credit in the amount of \$89 and \$86 at March 31, 2014 and December 31, 2013, respectively, all collateralized by a deposit in a restricted cash account.

Debenture note payable at December 31, 2013 consists of a \$1,400 note with Merlin Partners, LP. The debenture note bears interest at the rate of 6% and is due March 30, 2016. The debenture note is collateralized by a security interest in the trade name "Mace" and a pledge of the stock of Mace CSSS, Inc. The recorded value of the debenture note amount excludes unamortized discounts for warrants and a conversion option in the amount of \$262 and \$294 at March 31, 2014 and December 31, 2013,

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

March 31, 2014 and 2013

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

respectively. See Note 11, Related Party Transactions for additional information regarding the Merlin note.

**NOTE 9 – ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consist of the following:

	<u>March 31, 2014</u>	<u>December 31, 2013</u>
Accrued employee compensation	\$ 138	\$ 219
Co-operative advertising and other sales allowances	181	179
Deferred revenue	163	112
Accrued non-income based taxes	97	132
Other	<u>284</u>	<u>444</u>
 Total accrued expenses and other current liabilities	 <u>\$ 863</u>	 <u>\$ 1,086</u>

**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 exercisable based upon graduated vesting schedules as determined by the Committee.

As of March 31, 2014, 6,799,336 nonqualified stock options were outstanding under the 1999 and 2012 Plans.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014 and 2013

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

Activity with respect to these plans is as follows:

	<u>Number</u>	<u>Weighted Average Exercise Price</u>
Options outstanding at December 31, 2013	6,312,670	\$ 0.92
Options granted	537,500	\$ 0.39
Options expired	<u>(50,834)</u>	\$ 1.91
Options outstanding at March 31, 2014	<u>6,799,336</u>	\$ 0.92
Options exercisable	<u>4,340,136</u>	\$ 1.19
Shares available for granting of options	<u>10,821,000</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 \$86 and \$13 for the three months ended March 31, 2014 and 2013, respectively.

The fair values of the Company's options awarded during the three months ended March 31, 2014 were estimated at the dates of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

Expected term (years)	5
Risk-free interest rate	1.65%
Volatility	59.0%
Dividend yield	0%
Forfeiture rate	0%

**Expected term** - The Company's expected life 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.

At March 31, 2014, total unrecognized stock-based compensation expense is \$444, which has a weighted average period to be recognized of approximately 3.5 years.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014 and 2013

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

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.

In 2010, the Company issued warrants to purchase a total of 314,715 shares of the Company's stock at an exercise price of \$0.20 per share in connection with a Promissory Note with Merlin Partners, LP. The warrants were accounted for under the equity method at a Black-Scholes' fair value of \$0.20 per share or a total value of \$63,274 and are classified in equity. No warrants to purchase common stock related to the note have been exercised through March 31, 2014. These warrants were issued with an expiration date of December 28, 2015.

In 2011, the Company issued additional warrants to purchase a total of 1,428,535 shares of the Company's stock at an exercise price of \$0.20 per share in connection with the December 2010 Promissory Note with Merlin Partners, LP and a March 2011 Debenture Agreement with Merlin Partners, LLP. The 1,428,535 warrants issued in 2011 included 1,271,178 warrants issued on August 2, 2011 upon completion of the Company's Rights Offering under anti-dilution provisions contained in the original issued warrants. See Note 11, Related Party Transactions. The warrants issued in March 2011 in connection with the Debenture Agreement were accounted for under the equity method at a Black-Scholes' fair value of \$0.20 per share or a total value of \$47,420. No warrants to purchase common stock related to the note or debenture have been exercised through March 31, 2014.

During the exercise period, the Company will reserve a sufficient number of shares of its common stock to provide for the exercise of the rights represented by option holders.

### NOTE 11 – RELATED PARTY TRANSACTIONS

At March 31, 2014, the Company leases office space in Bennington, Vermont under a lease between Vermont Mill Properties, Inc. and the Company. The current lease expired on March 31, 2014. Vermont Mill is controlled by Jon E. Goodrich, a former director and former employee of the Company. Rent expense under this lease was \$7 and \$32 for the three months ended March 31, 2014 and 2013, respectively.

On March 30, 2011, the Company borrowed \$1,400 with an interest rate of 6% per annum from Merlin Partners, LP ("Merlin") to fund the acquisition of TCCI, a wholesale security monitoring company. The loan is secured by a security interest in the "Mace" name and a pledge of the stock of the Mace CSSS, Inc. (the "Company's wholesale monitoring subsidiary). The loan was originally due March 30, 2013; however, Merlin had the right to call the loan commencing on September 27, 2011, forty trading days after the completion of the Company's Rights Offering and Merlin's purchase of the Additional Stock (the "Call Trigger Event"). Merlin's right to call the loan expired on March 27, 2012, six months from September 27, 2011. As Merlin did not call the loan by March 27, 2012, the maturity date of the loan automatically extended to March 30, 2016 with Merlin continuing its right to convert the loan into common stock through March 30, 2016, the new maturity date. The conversion right is at a per share price of \$0.21 which is equal to the ten day average closing sales price of the common stock, starting with September 14, 2011, the trading day which is 30 trading days after the Call Trigger Event. In accordance with ASC 815, "Derivatives and Hedging," the Company determined that the conversion feature of the

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014 and 2013

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

Debenture met the criteria of an embedded derivative, and therefore the conversion feature of this Debenture needed to be bifurcated and accounted for as a derivative. The conversion option was marked-to-market each reporting period, with future changes in fair value reported in earnings. The fair value of the embedded conversion was estimated at \$590 at the date of issuance of the debenture and each subsequent quarter using the Monte Carlo model with the following assumptions: risk free interest rate: 0.16%; expected life of the option to convert of 4.7 years; and volatility: 48%. With the Call Trigger Event occurring and the conversion price and number of conversion shares known, the fair value of the conversion option was estimated at \$516 at September 30, 2011 using the Black-Scholes valuation model. Accordingly, for the year ended December 31, 2011, the Company recorded a gain on valuation of derivative of \$74 to reflect the reduction in the market value of the derivative. Additionally, with the debenture conversion price and number of conversion shares to be issued upon a conversion known, the initial bifurcated derivative no longer met the criteria to be recorded as a derivative liability. Accordingly, the \$516 conversion option at September 30, 2011, was reclassified from a liability to stockholder's equity as additional paid-in-capital and as a discount to the \$1,400 Merlin loan. The conversion option is being accreted as a charge to interest expense over a 60 month period with an offsetting credit to the loan balance.

As compensation for the \$1,400 loan, Merlin received a five year warrant exercisable into 157,357 shares of common stock at an exercise price of \$0.20 per share. The warrant contains an anti-dilution provision that provides that the Company will 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 will be exercisable at \$0.20 cents per share. On August 2, 2011, after the completion of the Company's Rights Offering, a warrant for 423,726 shares was issued to Merlin under the anti-dilution provision. The conversion features of the loan and the warrant may result in additional dilution to stockholders. 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 Merlin loan and as additional paid-in capital. The discount is being accreted as a charge to interest expense over the initial 24 month maturity period of the loan with an offsetting credit to the loan balance. Merlin received \$21 of interest related to the \$1,400 loan in the three months ended March 31, 2014 and 2013. In addition, the Company recognized non-cash interest expense for the accretion of the discounts to the Merlin promissory note and debenture for related warrants and a conversion option of \$32 and \$35 in the three months ended March 31, 2014 and 2013, respectively.

### NOTE 12 – SUBSEQUENT EVENTS

The Company evaluated its March 31, 2014 financial statements for subsequent events through April 25, 2014, the date the financial statements were available to be issued. The Company is not aware of any other subsequent events which would require recognition or disclosure in the consolidated financial statements.