Mace Security International Inc.

Moderator: Medved, Gary
November 2, 2021
11:00 AM ET

OPERATOR: This is Conference # 1092552

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Mace Security International Third Quarter 2021 Earnings Call. At this time, all participants are in a listen-only mode. After this speaker's presentation, there will be a question-and-answer session. Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your first speaker today, Mike Weisbarth. Thank you. Please go ahead, Mr. Weisbarth.

Michael Weisbarth: Thank you, Brian, and good morning, everyone. Joining me on the call today is Sanjay Singh, our Executive Chairman; along with Gary Medved, the President and Chief Executive Officer of Mace. Please visit corp.mace.com under Newsroom where you can find additional materials, including the financial statements and the OTCQX report for the third quarter ended September 30, 2021, as well as our Q3 financial overview presentation.

Before proceeding, I'd like to point out that certain statements and information during the conference call will constitute forward-looking statements and are based on management's expectations and information currently in the possession of management. When used during our conference call, the words or phrases such as will likely result, are expected to, will continue, is anticipated, estimated, projected and intended to or other similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks, known and unknown, and uncertainties, including, but not limited to, economic conditions, limited capital resources and disruptions in domestic and international supply chains. Such factors could materially affect Mace's financial performance and could cause Mace's actual results for the future periods to differ materially from any opinions or statements expressed during this call.

I will now turn the call over to Sanjay for some comments about the quarter.

Sanjay Singh: Thank you, Mike. Good morning, everyone. This quarter looks very different from the third quarter last year. We were dealing with sizzling demand and lack of capacity issues in 2020, but we also realized that the consumers who were clamoring for our products had an increased awareness of their personal safety needs and a lot of it was driven by the social unrest events. So, we made a conscious decision to take an omnichannel approach, diversify our distribution channels and worked hard to make our brand more recognizable with the idea of increasing our reach.

Our bets on Amazon last year have paid off, witnessed by the growth of 359% when compared to 2019 POS data. We're now working hard to strengthen the mace.com platform. Both these initiatives require funds, which we did not have last year. We did not even have a lender at one point. We made those investments in marketing and advertising with the idea that the top line benefits had to be realized concurrently as the funds were somewhat limited.

Our efforts to land the retailers we were hoping to realize began last year and earlier in the year. The results this quarter weren't great, and we are retooling our approach. While external circumstances like lower foot traffic, likely because of inflation, did affect some of the momentum in the quarter, our job is to figure out other approaches to bring our products, both new and existing, to the consumers who may or may not be aware of their personal safety needs. We have a lot of work to do to make that happen and are excited and committed to doing that for our customers.

We brought new retailers into our customer portfolio in the third quarter with the addition of over 5,600 Advance Auto and Carquest locations along with launching our products on Lowes.com and Target.com. We are excited about having these standout companies as our customers and partners. We improved our operational efficiencies and have not wavered from our online growth strategy, producing nearly 20% quarter-over-quarter growth and more than a 60% increase over the third quarter last year. Both increases are over a meaningful base.

I will now turn the call over to Gary to comment on the third quarter 2021 operational results.

Gary Medved: Thank you, Sanjay. Good morning, everyone, and thank you for joining us. As Sanjay mentioned, we made progress in several aspects of our business, which didn't necessarily resonate on our third quarter financial results. We have a number of new products under development that we expect to begin launching in early first quarter 2022. We're excited about the design and look of these new product releases and the early feedback from some of our current customers as well as potential customers has been very positive.

During the third quarter, we made modifications to our workforce based on skill set and operational needs and added several pieces of automation to our production and packaging areas towards the end of the second quarter. We have further identified automation opportunities for other processes that can be enhanced. We're focused on continuous improvement to enhance our manufacturing efficiencies and reduce non-productive costs from our model as we're experiencing increases in several raw material and component costs. We are concentrating our attention on all our controllable costs.

Our sales for the third quarter were down from our record third quarter sales in 2020. We were up against a difficult comparison on two fronts. First, there were several events in the U.S. social environment last year that amped up the immediate need for our safety products. Those events did not recur this year, and we're glad they did not, but it did have an impact on the impulse nature of our customers' purchasing habits. Secondly, our private label business was down over 70% from last year in the third quarter and is down 65% year-to-date.

We previously communicated that we ended our relationship with some private label customers at the end of last year. The private label comp softens in the fourth quarter this year, and we move past them at the start of 2022. For the most part, we have backfilled the reduction in private label sales with Mace-branded products through online and retail sales growth on a year-to-date basis. While the retail environment has been soft as of late, we have still gained traction for the year and expect to be able to add to our top line growth through brick-and-mortar and online retail growth. We have more folks going up and adding SKUs in our existing retail customer base, which slid one quarter from our anticipated expansion timeline.

Our retail sales now represent 53% of our total sales, up from 48% just a year ago. We experienced a slight increase in our international sales for the quarter, which is encouraging as many countries have been slow to recover from the multiple strains of COVID. We continue our international sales efforts and believe the worldwide market will begin to open back up.

We identified and previously communicated the pricing pressures we are seeing from some of our international suppliers due to the availability of materials, the cost of shipping and extended lead time requirements. This has led to challenges with cost containment as well as inventory management, but we've been able to utilize more domestic suppliers and continue to assess localizing our sourcing needs. We've experienced price increases on certain raw materials, ranging from 20% to 175% from a year ago. We're taking price increases where we can, and we'll continue down this path to avoid margin erosion.

We incurred additional R&D costs during the quarter for upcoming product launches and we'll continue to invest in R&D as the innovator of new products in the personal safety space. While our new products are usually an extension of our current offering, we believe that the products and features we will unveil will energize the personal safety category and be attractive within retail environment. We currently expect these products to hit the market early Q1 of next year.

I'll now turn the call over to Mike to discuss details behind the financial performance.

Michael Weisbarth: Thank you, Gary. Third quarter net sales were $3.8 million, a 20% decrease from the $4.8 million for the third quarter of 2020. This decrease in net sales was predominantly from the decline in private label sales, along with the softening in retail sales as we were up against very difficult record-setting sales in the third quarter of '20.

Gross profit decreased $436,000, or 22%, from our third quarter 2020 results. Our margin rate was 40%, down 1% from the 41% we achieved in the third quarter of last year, as lower sales volume led to deleveraging of our fixed manufacturing costs and increased freight costs had a negative impact as well. As Gary and Sanjay have mentioned, we have focused on and reduced our controllable variable costs.

SG&A expenses for the third quarter increased by $128,000 to $1.3 million, or 34% of net sales. We have continued on our strategic path of online advertising to further penetrate the DTC market, and we had an increase in our R&D costs leading to our new product innovation. Additionally, we recorded an increase in our loss provision on trade receivables, of which the majority of it is increases on balances with active customers and some of our larger customers as well. So, we anticipate some recovery.

As a result of the above, our net income was $142,000 for the quarter, down $540,000 from the third quarter of 2020 in which we posted record third quarter earnings. Net income was 4% of net sales compared to 14% achieved in the same period last year. EBITDA for the third quarter of '21 was $257,000, or 7% of net sales, compared to $682,000, or 17% of net sales last year, which also represented a third quarter record for Mace.

Third quarter adjusted EBITDA was at $317,000, down $567,000 from the $889,000 we recorded in the third quarter 2020. For the nine months ended September 30, net sales of $10.5 million were down $461,000, or 4%, in the first three quarters of 2020. Net income for the first nine months is $953,000, or 9% of net sales, compared to net income of $1.3 million for the same nine months of 2020 or a decline of $300,000. The current year results were strengthened by the $625,000 gain we recognized from the Paycheck Protection Program loan forgiveness that we obtained in the first half of this year.

Earnings per share were $0.01 per share for the first nine months of 2021 and $0.02 per share for the same period last year. We remain debt-free as of September 30 and have a cash balance of $378,000. We utilized cash for inventory to ensure on-hand levels for sales growth and to try to minimize the impact from supply chain disruptions and the delays we're seeing from supply chains.

We also spent funds on machine automation in our manufacturing facility, and we'll continue to invest where we identify meaningful returns. Our working capital increased approximately $200,000 over June and it was all in component inventory as our international and domestic supply chains have required us to maintain a higher level of safety stock.

Now I'll turn the call back over to Gary for some closing comments before we take questions.

Gary Medved: At this time, I will stop and open the line for questions. I would ask each caller to limit themselves to one question with one follow up to allow everyone a chance to participate. If we have additional time, we'll try to get you back into the queue. So, operator please open the line for questions. Thank you.

Operator: Ladies and gentlemen, as a reminder if you wish to ask a question, please press * followed by the number 1 on your telephone keypad. Again, that's *1 to ask a question.

First question, we have Andrew Shapiro. Your line is open.

Andrew Shapiro: Hi, thank you. Good morning. Your press release highlights that Mace launched sales into these four, we'll call it, new retail customers, the two online wings of Lowe's and Target and Advance Auto and Carquest. Was it at the beginning, middle or end of Q3 that each of these retailers were launched? And is it the full line of Mace products or limited product lines right now that you're selling to these new players?

Gary Medved: Advance Auto and Carquest started with the Kuros! alarm at a PDQ setting and Lowe's online took our top 40 products and Target also added the Kuros! alarm. In terms of timing, Advance Auto and Carquest, it was late Q3. It may have even rolled into beginning of Q4. And Lowe's was, I want to say, mid to late Q3 as well, okay. So, no full traction has been realized yet. And I know just because of the orders coming in, we just had another order placed for Advance Auto, which was larger than the first one. So, they're still in the process of rolling out.

Operator: Again, ladies and gentlemen, if you wish to ask question, please press * followed by the number 1 on your telephone keypad. Again, I would like each caller to limit themselves to one question with one follow up to allow everyone and chance to participate. If we have additional time, we'll try to get you back into the queue.

Next question, we have Ken Fell. Your line is open.

Ken Fell: Hi, good morning, guys. You talked about the restructuring of manufacturing costs, which you say are now lower by 30% over Q2 of 2020 and 18% over Q2 of 2021, those are some really great numbers, guys. How did you achieve such cost reductions and is there still maybe more reductions to come? Can you kind of talk about that a little bit?

Gary Medved: Ken, thank you. From a higher-level question, I'd like to stay at that level. One is, there are really three areas, okay and one is our staffing. And I think we pointed out in the release or maybe in the opening comments here in terms of staffing, getting it rightsized with the right skill set and cost structure, obviously, to match what we're foreseeing sales levels to be and what we're targeting for next year.

Number two is the direct labor force. And that goes hand-in-hand with the equipment that we've designed and brought in as well as acquiring equipment, process flow, redesigning components, which you wouldn't be able to see. We redesigned some items, some components for manufacturing and assembly.

The product look is the same, the product functions the same because the redesign was under the hood, so to speak. And so, all of those changes as they rolled out, and there have been five or six key changes that took place late Q2 going into Q3, that the efforts are being realized and they'll continue to be realized driving towards those margins and EBITDA numbers that we keep putting out there as our targets.

So direct labor, we went through a lot last year with temporary labor, the pandemic, day-cares, childcare, schools being shut down and the impact that it had on labor, now this year with 10 million people still out of the workforce and made it even more difficult. So likely, late last year, we recognized what we needed to do, and we put the CapEx out there. We got the equipment in, and it has helped drive improved efficiencies. And so, the scope of which have not been realized going through Q3's numbers. So, stay tuned for more on that. So that might be about as much detail as I want to leave with you folks right now.

Operator: Thank you. Next, we have a follow up question with Andrew Shapiro.

Andrew Shapiro: So, we know COVID, and the associated supply logistic issues have greatly impacted your costs. But to what extent do you consider these same issues to have been headwinds in your sales growth or lack of thereof? And I ask because on previous calls, you specifically called out that there were certain supply chain disruptions impacting sufficient stock on certain items. So where do you stand in your backlog and fulfilling past orders? And now that we've completed Q3 and are into Q4, those problems cleared up or when do you expect these issues from a sales ability to be overcome?

Sanjay Singh: Good morning, Andrew. I'll give you a strategic context, and Gary can certainly dive into the details, as can Mike or I. The supply chain issues have affected us in many different ways, you know product availability, the retailers' positioning, the retailers that we sell to being distracted with supply chain issues, not being able to take our meetings or meetings are getting postponed. And we've seen quite a few of those things. So, it has had an impact. You know I can't point a specific finger on one particular item, but those are the dynamics we live in today. That shouldn't take away from our focus of maybe building a much bigger pipeline knowing what's going on or certainly investing in some quicker return online revenues. So that's sort of the position that we've taken.

Andrew Shapiro: And to follow up. Yes, go on. Gary?

Gary Medved: No. Go on. I'll wait for your follow up, Andrew, as it might blend in.

Andrew Shapiro: As a follow-up, 769% Guard Alaska sales growth is obviously awesome number. But if it's off a minimal base, it's not as meaningful. What have the revenues grown to in Q3 in that category? And now the market share gains our brand has made against the recalled Sabre Frontiersman bear spray product, are those market share gains being maintained? Are they still expanding or are they starting to come back in now that they're out there doing their product again? And do you feel there are some share gains that will be kept for the long run?

Gary Medved: Yes. I think the first thing to keep in mind, Andrew, and this goes back to almost three years ago when I joined the company that Mace had acquired a private label filler that the two things, it chews up your resources in-house and you're building a brand to compete against you. Bottom line, that's what private label business does.

Now if you want to have a business all to itself, it does private label filling, you have no brand and have no desire for a brand, that's great. But when you have a brand with the tenacity that Mace has and the reach that Mace has and the recognition that Mace has, you got a private label filler. And as we mentioned on the last few phone calls here, one of those private label customers was a very large bear spray customer.

And so last year when social unrest was hitting and as we know a lot of people took to the outdoors last year when the pandemic lockdown occurred. Once they started loosening, everybody was flooding outside. And guess where our resources are going, our equipment, our people, our time, our money was going to build a brand for somebody else.

And much like the labor situation coming out of last year, I did not want to repeat that this year. And luckily, Mike found us the money. We invested in equipment. I designed some of the equipment on my own time. Got it built, got it in here and it's paying dividends. Well, we did the same thing with our Guard Alaska. We had a brand that, to your point, was next to nothing because the two brands that we did have, the Mace-branded bear spray and the Guard Alaska brand bear spray, neither were manufactured by us. One contained a carcinogen, trichloroethylene. We didn't want to manufacture that in-house until this day. Since the day I've walked in, we've never made a TCE-contained product in the walls of Mace.

The other one was purchased from a competitor of ours, a very strong competitor. And I'm like, why are we not focusing on our brands? So, we pivoted there. So, in terms of growth, yes, it went from a very low number to a super high number, but what it did and more critically and more importantly, what it did is it replaced more so the private label brand that we're no longer manufacturing. And it's replaced with higher margin, something we make in-house and it's our own brand.

To the second part of your question, we see growth ahead. We see us building this out going forward into 2022. It got a nice ramp here in 2021, and we're just going to continue on. We know where it works. We know the pricing. We know a lot more about bear sprays than we did three years ago. And I'm just not interested in making and filling cans and shipping to somebody else to compete with me on any front, whether it's a personal pepper spray or a bear spray.

So, in summary, yes, it's grown quite a bit from a small number. But the important thing that I take away is it replace more so the business that we have with private label. So, this is our brand we're building now. All right**,** thank you.

Operator: Thank you. Next, we have Vijay Marolia.

Vijay Marolia: Good morning, gentlemen. Gary, just speak on what you mentioned with the focus on the brand. And I think last time we discussed a little bit about demographics and how pretty much all of us on the call are considered elderly now. Do you have any focus on social media, specifically TikTok? And I'll admit, I'm not on there, but apparently, there's a bunch of consumers on there that are probably new to Mace.

Gary Medved: Yes. You should have a TikTok account [laugh]. To your point, we're working with an agency. I want to keep this high level, and again, this is a later development. This isn't something that we kicked off in January. Sanjay spent a fair amount of time in the last year-and-half or so on the digital side of the business, getting a full grasp on that and what its needs were and what we needed to do, that talent that we needed to have, all those pinch points and rolling into this year kind of became one of our strategic elements that we focused on. And I think the second half of this year is where it started to get legs working with an outside agency that really had their finger on the pulse of the demographic we're going after, the social media accounts. We barely scraped the surface, okay?

So, whatever you're seeing from us in terms of your, if you have a Facebook account that you're seeing a feed come through on Facebook or

Instagram. Okay. We're still in the trial A/B testing phase on some different things. So, you might see an ad pop up. You might see a post pop up. We're measuring that and we're dialing it in. But we're, Sanjay and I are very excited about who we're working with. And like I said, they got their finger on the pulse of this #1 demographic we're going after. We got some personas identified that we want to go after. And so, stay tuned on the social media and all things digital front going forward. I think you're going to see more, a lot more.

Operator: Thank you. Next, we have Ken Fell. Your line is open.

Ken Fell: Hi, again. We were supposed to have new products coming out this quarter. I believe 1 or 2 of them. And it seems like they've now slipped to 2022. Can you kind of talk about what the cost of that was?

Gary Medved: Sure. So, you know we did our homework, we did some design drawings. I sketched up what I was looking for, worked with a couple of industrial designers to give them a sweet look, we prototyped and prototyping in today's world is 3D printing. We modelled these up from a look standpoint, what we call a sight model, took them out, showed them to the demographic we're going after, got some feedback, tweaked it. And then when it came time to put rubber to the road, and again, keep in mind that anything that we design going forward, there's going to be a great emphasis on DFMA, which is designed for manufacturing and assembly. We're not too interested in designing a product that takes three people, 20 minutes to put together.

Now those changes facilitated the need for us to go back and try to fit some geometry in an area where there was no room for the geometry that we needed. And so, a sight model, you can hold, feel, say, oh, this feels good, or this feels like crap [ph] or this is how I hold it. It's got a good comfort feel to it. But that's only a block of material for form and shape. But when you get down to the inside and it's time to start developing it for function, that's when all the tight geometry comes into play. And so, we went through iteration after iteration.

We were making working models, the last couple of months, which we put money into. And we alluded to that with the R&D spend because these prototypes are not cheap. But we finally got it locked down. We finalized it a few weeks ago. They're in the tooling phase right now. And we'll have first shots out of the tool late this year. So, we don't anticipate any issues when those first shots come out because we're just playing metal safe on everything. So, if there's any tweaking, we have the material to do it. And we have shown sight models to a number of customers, potential customers and extremely positive feedback coming back.

So, patience is a virtue on these unfortunately. We have to be a little bit more patient. I would love to have had them out for Q4. I'm not happy with the roll of the schedule, but we want to get it right. And we just want to have something special and something that looks different, and it's welcomed by the consuming public out there. So that's pretty much all I can tell you. I will give you a hint that we do have one product line extension and it's a product line extension. So, it was a lot easier to get through that we're looking to introduce during Q4. Okay. The product line extension, it's got an attractive price point. It will be coming out in Q4, but there will be a much larger play in the next year or so on that one. Thanks, Ken.

Ken Fell: Great, look forward in the next year. Thanks Gary.

Gary Medved: Sure.

Operator: Thank you. Next, we have Andrew Shapiro. A follow-up question.

Andrew Shapiro: Yes. Actually, a little follow-up to Mr. Fell on the new products in the pipeline, but also on the new products you had introduced this last year. Regarding the new products in the pipeline, you described in your slide 2 bullet points. One was a new pepper spray model. And sounds like it's like a form factor and especially with your design changes and design hurdles you're doing, it sounds like that. I don't expect, but I'm hopeful you might be able to say what's different and value added, but can you say whether this product will have some proprietary features to it and not be subject to copycatting.

Gary Medved: Yes. First of all, on the slide, Andrew, if you're referring to the financial overview that we, I think Mike posted that last night. Slide 16 is our new product slide. There are actually three new pepper spray models. Okay. That was one of the bullet points. And so, one is the product line extension that's coming out this quarter. The other two are the ones that I was just referring to when I was answering Ken's question.

And yeah, it's more than just the look on these things. I'm talking to the patent attorneys now. There's some homework being done on utility, the function side of the patent, which is obviously more of what I'd like to have. So, we got to see what their search has come back with. I don't know if I can give much more than that away. They are pepper spray units. Folks got that out of me a couple of calls ago. If you have pepper spray, it's not the kind of thing for alarm. So, we'll leave it at that. But we'll get you from [inaudible] when we get them in production, okay? Get you real-time feedback.

Andrew Shapiro: And it's not a follow-up, but this is part. You also, in that same slide, you described new retail price points. So, with Mace already the premium brand, I'm assuming this is going to be a lower price point offering. And can such a lower price point offering offer similar margin to Mace?

Gary Medved: Well, let's say this. When I came in three years ago, we were you know there were questions, you know a few people had questions about, we need a product at this point, why don't we have a product at this price point? And you want to make sure that you get to the right price point with the right value proposition for our customer and not take an item right now that retails for $15.99 or $16.99 and get it down to a sub-$10 level. It's just going to degrade the brand.

So, with the approach that we're taking in the design, the assembly, the manufacturing, the goal is to design cost out of it from the get-go and still keep our margins regards to the price point. I don't care if it's a $10 item, a sub-$10 item, a $50 item, a $100 item, whatever it is, you know we've got a margin hurdle here that we want to meet. And you know it starts with the design of the product. It's taking all the cost out of that you can possibly take out. So, we're just not excited about taking a product that costs X and just squeezing the price down to where we're a pinch. I'd rather have the right product at different price points. And that could go from the low-price points or opening price points, all the way to the premium.

Operator: Thank you. Again, ladies and gentlemen, if you wish you to ask a question, please press *1 on your telephone. And I would like you to ask each caller to limit themselves to one question with one follow up to allow everyone have a chance to participate. Next, we have Vijay Marolia, a follow-up question.

Vijay Marolia: This next question is, I guess, a little more forward looking, but have you looked at any correlation between sales and voting season, whether it's local elections or state or national. Have you looked at anything like that?

Gary Medved: We haven't drawn the correlation with an election year or elections in general. As close as we come is, if you've reviewed the deck, you see Slide 11 in there where we kind of step back and say, what does this year look like compared to 2019? Because last year, face it, had a lot of noise, rolling from a pandemic and country shutting down, retailers shutting down, then we rolled from that low to a social unrest summer that just drove demand crazy into an election. So even last year's election got lost in all of the noise. But when we look at '19 versus '21, yes, we're on the right path, okay. And all that noise has been removed this year for the most part. Large private label customers had been removed. And we're still substantially up over 2019.

So, to the effected the election causes anything, [inaudible] last two election with Mr. Trump running, we're probably more antagonistic and with more fear mongering going on than any other elections I remember. I can't anticipate 2024 unless something else changes. But I think the elections of last year just kind of fed into the narrative of the entire year. There was just a lot of uneasiness, uncertainty, a lot of fear, and that's what happened last year.

I don't think we're going to see anything like today's the Virginia election, which I think the entire country is following, but I'm not expecting a sales spike today regardless of who wins the gubernatorial election out there. So, I think it has minimal impact. I think events like social unrest have much, much larger impact than election ever will.

Vijay Marolia: Thank you.

Operator: Thank you. Next, we have a follow-up with Andrew Shapiro.

Andrew Shapiro: Hi, sorry. My other new product question got cut off there. You had two new products in the handgrip stunner and Neon extensions of triple actions defense spray introduced on mace.com website at the end of 2020 that was kind of stated as your strategy that the new products will come out initially on mace.com and then with the data that you collect there, gain penetration into other digital platforms and into your bricks-and-mortar. What is the status and experience of introducing either of these new products from 2020 out into other digital platforms and as importantly, into your bricks-and-mortar retail?

Gary Medved: I think, Andrew, are you referring to the new products on Slide 16?

Andrew Shapiro: The ones that had come out last year, yes.

Gary Medved: Yes. Those actually came out this year, all three of those around the first four or five months of the year.

Andrew Shapiro: Okay. So, I'm off by the year, but what's the status and the experience of either into brick-and-mortar retail?

Gary Medved: Yes. The Guard Alaska bear spray is doing quite well in bricks-and-mortar retail. We have that out on the West Coast. We have it down South and Dick's Sporting Goods does a great job with it. The likes of Walmart will not sell bear spray. We've tried, at least not yet. And Cabela's also carries our Guard Alaska bear spray. So, where we can sell it in brick-and-mortar retail, we've been successful in getting it in there.

In terms of the Neon Triple Action, this is making its way more through distribution going into the police tactical shops and the mom-and-pop places, if you will, that serve those customers. It's a more aggressive product. The tear gas becomes an issue with retailers. CS, okay, is an issue with Walmart and so forth. So, the Neon Triple Action is doing pretty well. Online, as you can see, it's in our top 20, and it's also making its way into distribution to the smaller chains, if you will.

In terms of the palm stun device, the whole stun category is becoming unfortunately associated with guns in general. So retail or brick-and-mortar retailers have kind of taken a pass on stun devices. We're starting to sense pushback on even Amazon on stun devices as well. So we're still selling that. Year-to-date and it came out in late March, and it's #7 at mace.com and there's some of our better, what you would think would be better selling products are actually behind this point, #8, #9, #10, and so forth. So, all told, we're happy with them. We're learning about each one more and more each day. And likewise, when we come out with brand-new product in the first quarter, they'll first pop up on mace.com. They'll have a bigger marketing push and then we'll go from there.

Andrew Shapiro: And my follow-up moves down the income statement and now into the gross margins and stuff here. So, I'm trying to reconcile some things here. Presumably, private label sales are lower margins than our branded product. So, with those sales substantially lower and our branded product sales up, I'm trying to understand what type of customer or what type of products with lower gross margins gained more in our company's sales mix and what type of customers or products with higher margins became a smaller part of the sales mix for a mix shift to be causing a decline in our gross margin.

Gary Medved: Well, I think the bigger question, Andrew, is what other elements impacted that gross margin, okay. We have been getting, as we mentioned, cost increases on raw materials. Freight cost has been going drastically higher you know a container used to be $2,000 coming from Asia, it's over $20,000. Due to supply chain constraints, we've had to airfreight stuff here from across the country and from Asia, wherever it was, and there's a super high cost associated with that, but we didn't want to run retailers out of product. So, when you look at gross margin, that's capturing all of the manufacturing overhead, which that freight variances and purchase price variances all reside in the manufacturing overhead element. And that --

Andrew Shapiro: Oh, yea. I totally understand that, but you guys referenced sales mix, and that's what I got confused by.

Gary Medved: Yes. The sales mix, as we alluded, you know you can see who's growing, okay and that's online and there's an animal or the elephant in the room online. And although the margins start out very handsomely with them, they do have a lot of fees and costs that are associated with doing business with them. And we're working on price increases. We're working on efficiencies on the plant and locking into longer-term contracts, so we don't experience any more cost increases or at least to the extent that we have going forward. So, I think it's less about this one customer or about multiple customers and more about one very large rolling customer. And so, we just got to work on the cost structure and price increases to get them where we need them to be.

Andrew Shapiro: Okay. And I understand the digital marketing spend is generally in SG&A, but your co-op spending supporting programs with your retailers, is that in cost of goods sold or in SG&A as well? And are there co-op spend obligations for e-commerce side of retailers like dicks.com and walmart.com and where does that spend go? Is it SG&A or is it up in COGS?

Mike Weisbarth: It's actually up, and it gets us to our net sales, Andrew. Yes, it's netted right out of sales.

Andrew Shapiro: Okay. But the digital marketing spend is SG&A. So, when you do the Amazon digital marketing spend, that's not COGS, that's not net sales, that's done in SG&A?

Mike Weisbarth: That's correct.

Andrew Shapiro: Okay, great. I have further questions. Please come back to me.

Operator: Okay, Andrew. There are no other questions. You may continue with your questions.

Andrew Shapiro: Okay. I appreciate that. Can you discuss what you referred to in your slides as Phase two of a base cost reset and what that means, whether it's in COGS or revenues, the impact it's going to have.

Sanjay Singh: Yes, Andrew, what that is about is, these are the cost reduction moves that started in mid-quarter. And as Gary mentioned, we're not done with those yet. So that's what Phase two is. In other words, there are other cost reductions in play, okay that are we are targeting in the fourth quarter.

Andrew Shapiro: Okay. And while it's clear your inventory pre-stocking should address certain supply chain issues going forward, is there a meaningful amount of production cost via inventory that has been heavily pre-stocked comprising the sizable inventory increase that we see on the balance sheet, that there is now somewhat an inflation hedge in our balance sheet and our income statement now or not meaningful?

Mike Weisbarth: Yes, I think on two fronts. Andrew, that's a great observation, both in our finished goods. However, that's what we did build earlier in the first half, and that's what we commented on at the end of the second quarter. And then on the component parts, bringing them in advance because of the delays in the supply chain. As Gary mentioned, as we're seeing some of the proposed cost increases, we've been able to get ahead of that as well. So right now, the increase in the inventory is more in the component part cost. However, we still have an increase year-over-year in the finished goods with that labor content already in the finished goods cost.

Operator: Next, we have Vijay Marolia.

Vijay Marolia: Do you guys see this quarter's working capital spending similar to last quarter or do you think it's going to be a little less, a little more?

Mike Weisbarth: I would expect us at this time to probably neutral to a little less on the working capital spend.

Vijay Marolia: Okay.

Operator: Thank you. Next, again we have Andrew Shapiro.

Andrew Shapiro: I was following up here on the inventory. So, slide 9, sequential inventory days jumped again for the fourth straight quarter. But I also see that the average finished goods to your COGS sequentially decreased quite a bit. Can you provide some more color and context to the decline in the finished goods ratio? And has the overall inventory days ratio peaked or is an additional build needed? And can you bring down finished goods days inventory down even further or are we kind of at the optimal level?

Mike Weisbarth: No. We believe there's more that can be brought down there, Andrew. But again, it's a combination of both the finished goods as well as the components. And we are protecting ourselves right now with keeping a little higher inventory level. I won't mince words here. We're overinventoried for where we need to be, but it's kind of, like I said, a protection plan against the slow supply chain that we have going right now. So, we believe we can bring that down.

Andrew Shapiro: And have you achieved any success in onshoring more of the company's suppliers and logistics, which would greatly enable your ability to bring inventory down and harvest cash?

Mike Weisbarth: We have, yes. That's the simple answer. Yes.

Andrew Shapiro: Okay. Good. And that was recently implemented or we're already seeing the effects of it because we can't see the effects yet obviously.

Mike Weisbarth: Right. It was obviously this year and late second quarter, early third quarter.

Andrew Shapiro: And when do you guys expect to see the marketing spend growth to begin to be exceeded by gross profit growth so that we see progress, obviously, towards your 15% EBITDA margin goal?

Sanjay Singh: What was the first part of that, Andrew?

Andrew Shapiro: When do you expect marketing spend growth to become exceeded by gross profit growth? So, then we start seeing progress towards the EBIT margin goal of 15%.

Sanjay Singh: We are at a point now with our volumes were down, as you saw, 20%. There's a certain amount of volume that we need to be at that 15% EBITDA. If we weren't making the advertising investments, then we wouldn't see those related online sales. So they sort of, the cost lag the revenues a bit in the quarter. So I think we need to get our top line up, back up. That's what we need to do. That's our job. That's what is going to get us to the 15% EBITDA. We're not that far off.

Andrew Shapiro: Sanjay, do you guys have, I mean, do you have any ways you can articulate or the metrics in which your sizable marketing investments are paying back and how and when they will continue to pay back? Because I understand the lag, but how do you measure that? How do you know that what you're doing is successful?

Sanjay Singh: So, there are quite a few ways we measure it with our partners. At a high level, return on advertising spend is one. Best-in-class is 4. We're less than that at the moment. And the reason for that is, when we started these programs, a couple of months back with our agencies, you cast the net pretty wide first. You run a lot of A/B testing. There's a lot of iteration to it to sort of figure out the sweet spot. And that's just the way it is done. And so our ROAS is under best-in-class, although it is at a profitable level. Our conversions are also another metric. To give you an idea, on Amazon, we have a best-in-class conversion rate. It's double digits. There are some products that are in the teens. The best-in-class on a digital platform on average, if you're doing 4% conversion, you're doing really, really well. We're way above that at the moment.

Andrew Shapiro: Okay. And as a nano cap penny stock without any sell-side following, extra efforts have to be made on your part in order to optimize this company's valuation multiple to minimize your cost of capital and obviously maximize shareholder value here. On your investor website, you have only listed a virtual investor conference for this month and another in December, but have not yet added any for 2021. Either why have you guys have none scheduled or are listed for the first and second quarters of next year as those spots are getting reserved now and what are your investor outreach plans for the coming year?

Mike Weisbarth: Right now, we are still finalizing those. So that's why we haven't put anything on the site yet, Andrew. But when we have those scheduled, we want to make sure that we are getting into the right audiences, the right venues for each of them and looking at assessing at what we did, what we attended this year and where it makes the most sense for us to be in attendance for next year. So, once we have those ironed out, we'll get it scheduled.

Andrew Shapiro: Right. Because some of them are moving to in-person, which then requires a bunch more advanced planning for both your attendees as well as for you guys.

Mike Weisbarth: Right. We've got to look at those. And we do and we look at it from a cost perspective, as costs relative to return.

Andrew Shapiro: Yes. Now can Sanjay or Gary or someone here, can you guys discuss the over 600,000 options that were issued during this recent Q3 and to whom were the bulk granted to and with what terms they're vesting or strike price?

Mike Weisbarth: Andrew, those are previously issued, just trying to think of the number that you have isn't the one I've got in my head.

Andrew Shapiro: I was just looking at the financials from Q3 versus Q2, and there was a 600,000 option jump in options outstanding. They're not exercisable yet. So that's why I asked about the vesting or the strike price. And I didn't know if they were, the bulk was you know granted to a few executive officers or if this is more broadly disseminated too in the culture to all the employees or it's to the Board. You know where -- that's a large chunk in the quarter.

Mike Weisbarth: Our Board compensation is, they don't get paid cash, they get issued options.

Andrew Shapiro: Well, you can get back to me offline on that. I'd like to know kind of where that's going. And your September 30 allowance for doubtful accounts at over 20% of gross receivables, is that higher than normal? Can you expand or explain on what's contributing to the increase versus the 15% of gross receivables last year at the same seasonal September 30? And then if it was seasonal, that's why I went back a year to take a look at that. Is it due primarily to a single customer or a class of customer?

Mike Weisbarth: It's concentrated in our active customers, but you know, we have an accounting policy that we have to follow. With certain balances, we've already been in contact with the customer, but we have outstanding balances, partial pays, etcetera. When they reach a certain age, we have to, by policy, reserve them up to a certain level.

Andrew Shapiro: So, it's across the board late payers?

Mike Weisbarth: Yes.

Andrew Shapiro: Become across the board late payers?

Mike Weisbarth: It's not across the board. I mean, I do not want to communicate that our receivables are not healthy because they are. But when we have certain balances that extend beyond payment terms, then we have to reserve for them.

Sanjay Singh: Andrew, it's recoverable. Some of it may be recoverable. I mean, I think that's the punch line here. Our customers are not, they're going concerns. They're top companies, good performing companies.

Andrew Shapiro: I mean, I've been here for a long time, and so I was here for The Sports Authority bankruptcy, for example. So that's what I was trying to get at is to understand if they're just late payers across the board, if it's a single large customer. You kind of covered it. And good to know that most or all of it, you feel are recoverable. It's not like a pending bankruptcy. You guys said that an EBITDA to cash conversion rate was one of your key performance metrics or indicators and that you were trying to drive that number up towards a target. What are the steps or next on the plate to improve this rate? And what would you say the rate was this last quarter?

Sanjay Singh: So, we launched that initiative with all the supply chain issues, we were trying to get our products to our customers. We had to do airfreight. We had to carry a lot more inventory. So we are retooling that because there was just a lot of moving pieces that impacted us in the third quarter.

Andrew Shapiro: Okay. So, this has been an ongoing theme of this call. Can you provide maybe some summary color, et cetera, as to the areas that are getting worse for you, the areas that are stable and the areas that you are improving in terms of addressing this momentous challenge for both the small company and really for all kind of manufacturers and consumer products companies out there. It's not like this is unique to you, but you're smaller and what are you doing to overcome it? And where have you made progress? And where are there still like things that you're treading water on?

Sanjay Singh: So, this company does not have you know a middle management layer. So, it's, everybody is a doer. And we also have to look at the long-term, look out a few years. So, I would say that the things that have improved are on-time delivery or quality. We're nowhere there where we want to be and so we are making changes. Every month, we make changes to our processes. So that's what you know Gary mentioned the automation. So that has reduced our cycle time as we become more efficient. So, then you end up carrying less inventory, assuming that the supply chain, you know the suppliers are domestic. The ones that are abroad, that have longer lead times. Until we can on-shore, we still have to sort of maintain a decent level of inventory for our customers. I would say that's been the primary focus. It's been mostly operational.

What stands out in this quarter is you saw it in the net sales number. And we started seeing things that were not moving as quickly as we would have liked with the retailers for various reasons. So that's the other area where we have to, and we have, changed our approach drastically to address it. I hope that answers your question.

Andrew Shapiro: Yes. It will be a recurring question because it's an ongoing problem. So obviously, we bring the balance sheet and cash generation back in line.

Mike Weisbarth: Right. Yes, we agree. I'm not going to debate that one with you, Andrew. Well, we have reached an hour here. So, I'm going to turn it back over to the operator to wrap things up. And again, we appreciate everyone's interest in Mace and for participating on the call today.

Gary Medved: Thank you, everyone.

Michael Weisbarth: Thank you.

Sanjay Singh: Thank you.

Operator: All right. This concludes today's conference call. Thank you all for participating. You may now disconnect.