

Consolidated Financial Statements
Mace Security International, Inc.
June 30, 2024 and 2023

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Mace Security International, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

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

ASSETS	June 30, 2024	December 31,
	(Unaudited)	2023
Current assets:		
Cash and cash equivalents	\$ 60	\$ 239
Accounts receivable, less allowance for credit losses of \$97 and \$125 at June 30, 2024 and December 31, 2023,	498	755
Inventories	2,975	3,398
Other current assets	492	535
Total current assets	<u>4,025</u>	<u>4,927</u>
Property and equipment:		
Buildings and leasehold improvements	257	257
Machinery and equipment	2,184	2,179
Furniture and fixtures	109	109
Total property and equipment	<u>2,550</u>	<u>2,545</u>
Accumulated depreciation and impairment	<u>(2,497)</u>	<u>(2,491)</u>
Total property and equipment, net	53	54
Operating lease - right-of-use asset, net of amortization	1,011	1,122
Finance lease - right-of-use asset, net of amortization	21	31
Goodwill	739	739
Intangible assets, net of amortization and impairments	608	608
Other non-current assets	14	14
Total other assets	<u>2,393</u>	<u>2,514</u>
Total assets	<u><u>\$ 6,471</u></u>	<u><u>\$ 7,495</u></u>

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

Mace Security International, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

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

LIABILITIES AND SHAREHOLDERS' EQUITY	June 30, 2024	December 31,
	(Unaudited)	2023
Current liabilities:		
Line of credit	\$ 1,245	\$ 1,329
Derivative liability	253	99
Current operating lease obligation	231	223
Current finance lease obligation	21	19
Accounts payable	655	577
Income taxes payable	54	56
Accrued expenses and other current liabilities	260	370
Total current liabilities	<u>2,719</u>	<u>2,673</u>
Convertible debt , net of discounts	629	461
Subordinated note	270	-
Non-current operating lease obligations	802	920
Non-current finance lease obligations	1	12
Total liabilities	<u>4,421</u>	<u>4,066</u>
Shareholders' equity:		
Preferred stock, \$.01 par value; authorized 10,000,000 shares, no shares issued and outstanding at June 30, 2024 and December 31, 2023	-	-
Common stock, \$.01 par value; authorized 100,000,000 shares, issued shares of 66,596,075 and 65,817,049, at June 30, 2024 and December 31, 2023, respectively	666	658
Additional paid-in capital	104,273	104,199
Accumulated deficit	(102,867)	(101,406)
	<u>2,072</u>	<u>3,451</u>
Less treasury stock at cost, 90,548 shares at June 30, 2024 and December 31, 2023	(22)	(22)
Total shareholders' equity	<u>2,050</u>	<u>3,429</u>
Total liabilities and shareholders' equity	<u>\$ 6,471</u>	<u>\$ 7,495</u>

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

Mace Security International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(Amounts in thousands)

	Six Months Ended June 30,	
	2024	2023
Net sales	\$ 2,718	\$ 3,414
Cost of goods sold	<u>1,860</u>	<u>2,486</u>
Gross profit	858	928
Selling, general, and administrative expenses	2,015	2,119
Amortization of intangible assets	-	130
Operating loss	<u>(1,157)</u>	<u>(1,321)</u>
Interest expense	(172)	(55)
Loss on derivative liability	<u>(132)</u>	<u>-</u>
Loss before income tax provision	<u>(1,461)</u>	<u>(1,376)</u>
Income tax provision	<u>-</u>	<u>-</u>
Net loss	<u><u>\$ (1,461)</u></u>	<u><u>\$ (1,376)</u></u>
Net loss per share		
Basic	\$ (0.02)	\$ (0.02)
Diluted	\$ (0.02)	\$ (0.02)
Weighted average number of common shares (basic)	66,199,952	65,111,340
Weighted average number of common shares (diluted)	66,199,952	65,111,340

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

Mace Security International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(Amounts in thousands)

	Three Months Ended June 30,	
	2024	2023
Net sales	\$ 1,360	\$ 1,753
Cost of goods sold	951	1,235
Gross profit	409	518
Selling, general, and administrative expenses	947	1,050
Amortization of intangible assets	-	65
Operating loss	(538)	(597)
Interest expense	(90)	(32)
Loss on derivative liability	(94)	-
Loss before income tax provision	(722)	(629)
Income tax provision	-	-
Net loss	\$ (722)	\$ (629)
Net loss per share		
Basic	\$ (0.01)	\$ (0.01)
Diluted	\$ (0.01)	\$ (0.01)
Weighted average number of common shares (basic)	66,335,527	65,163,484
Weighted average number of common shares (diluted)	66,335,527	65,163,484

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited)

(Amounts in thousands, except share information)

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Accumulated Deficit</u>	<u>Treasury Stock</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>				
Balance at January 1, 2023	65,039,030	\$ 650	\$ 104,018	\$ (96,975)	\$ (22)	\$ 7,671
Stock-based compensation	778,019	8	181	-	-	189
Net loss	-	-	-	(4,431)	-	(4,431)
Balance at December 31, 2023	<u>65,817,049</u>	<u>\$ 658</u>	<u>\$ 104,199</u>	<u>\$ (101,406)</u>	<u>\$ (22)</u>	<u>\$ 3,429</u>
Balance at December 31, 20223	65,817,049	\$ 658	\$ 104,199	\$ (101,406)	\$ (22)	\$ 3,429
Stock-based compensation	779,026	8	74	-	-	82
Net loss	-	-	-	(1,461)	-	(1,461)
Balance at June 30, 2024	<u>66,596,075</u>	<u>\$ 666</u>	<u>\$ 104,273</u>	<u>\$ (102,867)</u>	<u>\$ (22)</u>	<u>\$ 2,050</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)

	Six Months Ended	
	June 30,	
	2024	2023
Cash Flows from Operating Activities:		
Net loss	\$ (1,461)	\$ (1,376)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization, including right-of-use asset amortization	126	355
Amortization of debt discount	39	-
Stock-based compensation	82	101
Provision for losses on receivables	19	16
Loss on derivative liability	132	-
Changes in operating assets and liabilities:		
Accounts receivable	238	148
Inventories	424	159
Other current assets	42	197
Accounts payable	79	68
Accrued expenses and other current liabilities	(110)	(205)
Operating lease obligations	(110)	(93)
Income taxes payable	(2)	(1)
Net cash used in operating activities	<u>(502)</u>	<u>(631)</u>
Cash Flows from Investing Activities:		
Purchase of property and equipment	(4)	(29)
Net cash used in investing activities	<u>(4)</u>	<u>(29)</u>
Cash Flows from Financing Activities:		
Proceeds from line of credit	2,572	985
Repayments of line of credit	(2,656)	-
Convertible debt offering proceeds	150	-
Subordinated note proceeds	270	-
Payments on financing lease obligations	(9)	(10)
Net cash provided by financing activities	<u>327</u>	<u>975</u>
Net increase (decrease) in cash and cash equivalents	(179)	315
Cash and cash equivalents at beginning of year	239	62
Cash and cash equivalents at end of period	<u>\$ 60</u>	<u>\$ 377</u>

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(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's independent auditors have not performed an audit or review of these consolidated financial statements.

Mace Security International, Inc. operates in one business segment, the Security Segment, which sells personal safety and security products to retailers, distributors, and individual consumers. The Company also sells tactical spray products and systems to law enforcement, security professionals, correctional institutions and military markets.

These unaudited consolidated financial statements should be read in conjunction with the Company's December 31, 2023 audited 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.

Going Concern

The accompanying consolidated financial statements of the Company have been prepared assuming the Company will continue as a going concern and in accordance with generally accepted accounting principles in the United States of America. The going concern basis of presentation assumes that the Company will continue in operations one year after the date these financial statements are issued and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. Pursuant to the requirements of the Financial Accounting Standards Board's Accounting Standards Codification (the “ASC”) Topic 250-40, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, management must evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year from the date these financial statements are issued. This evaluation does not take into consideration the potential mitigating effects of management's plans that have not yet been fully implemented or are not within control of the Company as of the date the financial statements are issued. When substantial doubt exists under this methodology, management evaluates whether the mitigating effect of its plans sufficiently alleviates substantial doubt about the Company's ability to continue as a going concern. The mitigating effect of management's plans, however, is only considered if both (1) it is probable that the plans will be effectively implemented within one year after the date that the financial statements are issued, and (2) it is probable that the plans, when implemented, will mitigate the relevant conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued.

On October 20, 2023, the Company's bank line of credit was repaid with the proceeds of a \$2,000 revolving credit loan from a commercial asset-based lender (“2023 Credit Agreement”). The credit facility matures in 3 years, and bears interest at Wall Street Prime plus 6 percent, with a floor of 14.25%. This new credit facility is secured by substantially all assets of the Company. The amount drawn under the new credit facility was \$1,245 and \$1,329 at June 30, 2024 and December 31, 2023, respectively.

The Company closed a non-brokered private placement of an \$150 unsecured subordinated convertible note and a \$150 unsecured subordinated note with a board member on March 7, 2024 and March 21, 2024, respectively; a \$100 unsecured subordinated note with a board member on May 23, 2024; and a \$100 unsecured subordinated note with a board member on June 25, 2024 (\$20 was drawn at June 30, 2024). The convertible note has a principal amount of \$150, matures on July 27, 2025, 10% per annum simple interest and is convertible into common shares of the Company at a conversion price of \$0.0852 per

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

common share. This convertible note's terms are the same as the terms of the \$590 convertible notes closed on July 27, 2023. The \$150 unsecured subordinated note is due the sooner of July 22, 2025, upon the repayment of the 2023 Credit Agreement, or termination of the individual. The note bears interest at 10% per annum and has no conversion features. This additional funding was provided because the terms of the Company's asset-based financing are heavily weighted toward finished inventory, and the Company has had some success in its efforts to reduce inventory levels which has resulted in reduced borrowing availability.

The Company has experienced significant operating losses due to lower sales levels in recent quarters. The amount of credit available under the 2023 Credit Agreement due to these lower sales levels may not provide sufficient working capital for the Company. Alternative sources of financing may need to be obtained. There are no assurances that such financing would be available to the Company on favorable terms or at all. The Company's ability to obtain financing in the debt and equity capital markets is subject to several factors, including market and economic conditions, the Company's performance, and investor sentiment with respect to the Company. These factors raise substantial doubt regarding the Company's ability to continue as a going concern for a period of at least one year from the date of issuance of these consolidated financial statements.

NOTE 2 – REVENUE

Virtually all the Company's net sales are generated from products sold at a point in time through ship-and-bill performance obligations. Revenue is recognized at a point in time when obligations under the terms of a contract with the Company's customer are satisfied. Generally, this occurs with the transfer of control of the Company's products at the time of shipment of products. Revenue is measured as the amount of consideration the Company expects to receive in exchange for transferring product. In some cases, the nature of the Company's contracts give rise to variable revenue as defined in Accounting Standards Codification ("ASC") topic 606, including rebates, credits, allowances for returns or other similar items that decrease the transaction price. These variable amounts generally are credited to the customer based on achieving certain levels of sales activity, product returns and making payments with specific terms. Variable revenue is estimated at the most likely amount that is expected to be earned. Such estimated amounts are recognized when revenue is recorded. Estimates of variable revenue and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of the anticipated performance and all information (historical, current, and forecasted) that is reasonably available.

Sales, value-added or other taxes collected by the Company concurrent with revenue producing activities are excluded from revenue. The Company allows some customers to return product when the product is defective as manufactured. The Company accrues for estimated future warranty cost in the period in which the sale is recorded. The expected cost associated with the Company's warranties is recognized in cost of goods sold in the consolidated statements of income. The Company calculates its warranty accrual based on its historic warranty loss experience. Amounts billed to customers in sales transactions related to shipping and handling represent revenue earned for the product provided and are included in net sales. Costs of shipping and handling are included in cost of goods sold.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

The following table disaggregates the Company's net sales by type of customer.

<u>Net Sales by Type of Customer</u>	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2024</u>	<u>2023</u>	<u>2024</u>	<u>2023</u>
Consumer	\$ 1,205	\$ 1,453	\$ 2,452	\$ 2,980
Tactical	49	55	99	125
International	34	137	37	170
Other	72	108	130	139
Total	<u>\$ 1,360</u>	<u>\$ 1,753</u>	<u>\$ 2,718</u>	<u>\$ 3,414</u>

NOTE 3 – NET INCOME PER SHARE

The Company's net loss per share was computed by dividing net loss by the weighted-average number of common shares outstanding for each respective period. Diluted loss per share was calculated by dividing net loss by the weighted-average number of all potentially dilutive common shares that were outstanding during the periods presented using the treasury stock method.

The calculation of basic and diluted loss per share were as follows:

	<u>Three Months Ended June 30,</u>	
	<u>2024</u>	<u>2023</u>
Numerator		
Net loss	\$ (722)	\$ (629)
Denominator		
Determination of shares		
Weighted-average common shares outstanding	66,335,527	65,163,484
Dilutive effect – share based awards	-	-
Diluted weighted-average common shares outstanding	<u>66,335,527</u>	<u>65,163,484</u>
Loss per common share		
Basic	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
Diluted	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>

Outstanding stock options relating to approximately 2,474,166 and 2,904,166 weighted-average shares were excluded from the calculation of diluted loss per share for the three months ended June 30, 2024 and 2023 respectively, as the impact of including such stock options in the calculation of diluted earnings per share would have an anti-dilutive effect, respectively.

Mace Security International, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

	Six Months Ended June 30	
	<u>2024</u>	<u>2023</u>
Numerator		
Net loss	\$ (1,461)	\$ (1,376)
Denominator		
Determination of shares		
Weighted-average common shares outstanding	66,199,952	65,111,340
Dilutive effect – share based awards	-	-
Diluted weighted-average common shares outstanding	<u>66,199,952</u>	<u>65,111,340</u>
Loss per common share		
Basic	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>
Diluted	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>

Outstanding stock options relating to approximately 2,558,523 and 3,136,476 weighted-average shares were excluded from the calculation of diluted loss per share for the six months ended June 30, 2024 and 2023, respectively, as the impact of including such stock options in the calculation of diluted earnings per share would have an anti-dilutive effect.

NOTE 4 – ADOPTION OF NEW ACCOUNTING STANDARD

There were no new accounting pronouncements in 2024 that had or are expected to have a material impact on the Company's Consolidated Financial Statements.

NOTE 5 - SUPPLEMENTARY CASH FLOW INFORMATION

Interest paid on all indebtedness was approximately \$96 and \$48 for the six months ended June 30, 2024 and 2023, respectively.

Income taxes paid were \$2 and \$1 for the six months ended June 30, 2024 and 2023, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

NOTE 6 – GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets consist of:

	<u>Estimated Useful Life</u>	<u>Original Cost</u>	<u>Accumulated Amortization/ Impairment</u>	<u>Net Book Value</u>
<u>March 31, 2024</u>				
Goodwill		\$ 1,031	\$ (292)	\$ 739
Non-amortized trademarks		<u>685</u>	<u>(77)</u>	<u>608</u>
Total goodwill and intangible assets		<u>\$ 1,716</u>	<u>\$ (369)</u>	<u>\$ 1,347</u>

	<u>Estimated Useful Life</u>	<u>Original Cost</u>	<u>Accumulated Amortization</u>	<u>Impairment</u>	<u>Net Book Value</u>
<u>December 31, 2023</u>					
Goodwill, net of impairments		\$ 1,031	\$ -	\$ (292)	\$ 739
Non-competition agreement	4 years	20	(20)	-	-
Trademarks	15 years	630	(260)	(370)	-
Customer Relationships	9 years	1,936	(1,445)	(491)	-
License	3 years	150	(150)	-	-
Patents	15 years	39	(13)	(26)	-
Non-amortized trademarks		<u>685</u>	<u>-</u>	<u>(77)</u>	<u>608</u>
Total intangible assets		<u>3,460</u>	<u>(1,888)</u>	<u>(964)</u>	<u>608</u>
Total goodwill and intangible assets		<u>\$ 4,491</u>	<u>\$ (1,888)</u>	<u>\$ (1,256)</u>	<u>\$ 1,347</u>

Amortization of intangible asset expense was \$0 and \$65 for the three months ended June 30, 2024 and 2023, respectively, and \$0 and \$130 for the six months ended June 30, 2024 and 2023, respectively.

All the goodwill is expected to be deductible for income tax purposes. The Company's goodwill and non-amortized trademarks are not amortized, but instead are subject to an annual impairment test. The most recent evaluation was performed as of December 31, 2023. As a result of this evaluation, the Company recognized a \$964 intangible asset impairment charge and a \$292 goodwill impairment charge in the fourth quarter of 2023. No future amortization of intangible assets is expected.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

NOTE 7 – INVENTORIES

Inventories consist of the following:

	<u>June 30, 2024</u>	<u>December 31, 2023</u>
Raw materials	\$ 1,129	\$ 1,353
Finished goods	1,846	2,045
Total inventories	<u>\$ 2,975</u>	<u>\$ 3,398</u>

NOTE 8 – LONG-TERM DEBT

Long-term debt consists of the following:

	<u>June 30, 2024</u>	<u>December 31, 2023</u>
Line of credit	\$ 1,245	\$ 1,329
Convertible notes, net of discount	629	461
Subordinated notes	270	-
Less: current portion of debt	<u>(1,245)</u>	<u>(1,329)</u>
Total long-term debt	<u>\$ 899</u>	<u>\$ 461</u>

Line of credit:

The Company had a \$3,000 line of credit agreement with a bank (the “2021 Credit Agreement”). The 2021 Credit Agreement was secured by substantially all the Company’s assets. The 2021 Credit Agreement requires monthly interest payments. On May 25, 2023, the 2021 Credit Agreement was amended (the “May 2023 Amendment”) to extend the maturity date to July 31, 2023. The May 2023 Amendment reduced the credit agreement facility to \$1,500 and provided for the increase in the interest rate effective May 25, 2023 to SOFR plus 4.0%, with a floor of 4.0%. On July 31, 2023, the 2021 Credit Agreement was further amended (the “July 2023 Amendment”) to extend the maturity date of the bank line of credit to September 30, 2023 from July 31, 2023. The July 2023 amendment increased the rate of interest to SOFR plus 6% from SOFR plus 4%. The Company recognized \$0 and \$31 interest expense associated with 2021 Credit Agreement for the three months ended June 30, 2024 and 2023, respectively, and \$0 and \$52 interest expense associated with the 2021 Credit Agreement for the six months ended June 30, 2024 and 2023, respectively.

On October 20, 2023, the 2021 Credit Agreement was repaid with the proceeds of a \$2,000 revolving credit loan from a commercial asset-based lender (“2023 Credit Agreement”). This credit facility matures on October 20, 2026, and bears interest at Wall Street Prime plus 6 percent, with a floor of 14.25%. The interest rate at June 30, 2024 was 14.50%. This credit facility is secured by substantially all assets of the Company. The amount drawn under this credit facility was \$1,245 and \$1,329 at June 30, 2024 and December 31, 2023, respectively. The Company recognized \$44 of interest expense associated with 2023 Credit Agreement for the three months ended June 30, 2024 and \$89 interest expense for the six months ended June 30, 2024.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

Convertible Notes:

The Company closed a non-brokered private placement of unsecured convertible notes with board members and shareholders on July 27, 2023 (“2023 Convertible Notes”). The 2023 Convertible Notes have an aggregate principal amount of \$590 and have a two-year term, 10% per annum simple interest and are convertible into common stock of the Company at a conversion price of \$0.0852 per common stock equivalent to a 20% premium of the share price in the last 60 trading days prior to the closing date. If interest is not paid when due, whether at stated maturity, by acceleration, or otherwise, such unpaid interest shall be cumulative, accruing until paid. The 2023 Convertible Notes are subordinated in right of payment to all current and future indebtedness of the Company for borrowed money.

The Company closed a non-brokered private placement of unsecured convertible notes with a board member on March 7, 2024 (“March 2024 Convertible Note”). The March 2024 Convertible Note has an aggregate principal amount of \$150 and matures on July 27, 2025, 10% per annum simple interest and is convertible into common stock of the Company at a conversion price of \$0.0852 per common stock equivalent to that of the 2023 Convertible Notes. If interest is not paid when due, whether at stated maturity, by acceleration, or otherwise, such unpaid interest shall be cumulative, accruing until paid. The March 2024 Convertible Note is subordinated in right of payment to all current and future indebtedness of the Company for borrowed money.

The principal balance and unpaid accrued interest on all convertible notes will automatically convert into Common Stock of the Company upon the closing of the next sale (or series of related sales) by the Company of its Equity Securities following the date of issuance of the convertible notes with the principal purpose of raising capital and from which the Company receives aggregate gross proceeds of not less than \$1,000.

In the event of a Corporate Transaction as defined prior to the conversion or the repayment of the convertible notes, at the closing of such Corporate Transaction, the Holder may elect that either: (a) the Company will pay the Holder an amount equal to the sum of (x) all accrued and unpaid interest due on the 2023 Convertible Notes and (y) 1.15 times the outstanding principal balance of the convertible notes; or (b) the convertible notes will convert into that number of Common Stock equal to the quotient (rounded down to the nearest whole share) obtained by dividing (x) the outstanding principal balance and unpaid accrued interest of the convertible notes on a date that is no more than five (5) days prior to the closing of such Corporate Transaction/the date of conversion by (y) the applicable Conversion Price.

At any time, at the election of the Holder, the convertible notes will convert into that number of Common Stock equal to the quotient (rounded down to the nearest whole share) obtained by dividing (x) the outstanding principal balance and unpaid accrued interest of the convertible notes on the date of such conversion by (y) the Conversion Price of \$0.0852 per share.

The Company recorded \$156 as the fair value of the embedded derivative liability associated with the 2023 Convertible Notes on July 27, 2023, with a corresponding amount recorded as a discount to the 2023 Convertible Notes. The debt discount is amortized to interest expense over the term of the 2023 Convertible Notes using the effective interest method using an effective interest rate of 27.1%. Changes in the fair value of the embedded derivative liability are recorded in the Statement of Operations in the period in which the changes occurred.

The Company recorded \$21 as the fair value of the embedded derivative liability associated with the March 2024 Convertible Note on March 7, 2024, with a corresponding amount recorded as a discount to the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

March 2024 Convertible Note. The debt discount is amortized to interest expense over the term of the March 2024 Convertible Note using the effective interest method using an effective interest rate of 22.0%. Changes in the fair value of the embedded derivative liability are recorded in the Statement of Operations in the period in which the changes occurred

The following table provides a reconciliation of the beginning and ending balances for the convertible notes:

	<u>June 30, 2024</u>	<u>December 31, 2023</u>
Face value of convertible notes at issuance	\$ 740	\$ 590
Less: debt discount in form of embedded derivative liability at fair value	177	156
Add: amortization of debt discount	<u>66</u>	<u>27</u>
Balance	<u>\$ 629</u>	<u>\$ 461</u>

Convertible note interest expense for the three months ended June 30, 2024 and 2023 was \$39 and \$0, respectively, of which \$18 and \$0, respectively, related to contractual interest expense and \$21 and \$0, respectively, related to amortization of the discount. Convertible note interest for the six months ended June 30, 2024 and 2023 was \$73 and \$0, respectively, of which \$34 and \$0, respectively, related to contractual interest expense and \$39 and \$0, respectively, related to amortization of the discount.

Subordinated Note:

The Company closed a \$150 unsecured subordinated note with a board member on March 21, 2024 (“March 2024 Subordinated Note”). The March 2024 Subordinated Note is due the sooner of July 22, 2025, upon repayment of the 2023 Credit Agreement, or termination of the individual. The note bears interest at 10% per annum simple interest and has no conversion features. Interest is due at maturity. The March 2024 Subordinated Note is subordinated in right of payment to all current and future indebtedness of the Company for borrowed money. Subordinated note interest expense for the three months ended June 30, 2024 and 2023 was \$4 and \$0, respectively, and for the six months ended June 30, 2024 and 2023 \$4 and \$0, respectively.

The Company closed a \$100 unsecured subordinated note with a board member on May 23, 2024 (“May 2024 Subordinated Note”). The May 2024 Subordinated Note is due the sooner of July 22, 2025, upon repayment of the 2023 Credit Agreement, or termination of the individual. The note bears interest at 10% per annum simple interest and has no conversion features. Interest is due at maturity. The May 2024 Subordinated Note is subordinated in right of payment to all current and future indebtedness of the Company for borrowed money. Subordinated note interest expense for the three months ended June 30, 2024 and 2023 was \$1 and \$0, respectively, and for the six months ended June 30, 2024 and 2023 \$1 and \$0, respectively.

The Company closed a \$100 unsecured subordinated note with a board member on June 25, 2024 (“June 2024 Subordinated Note”). The June 2024 Subordinated Note is due the sooner of July 22, 2025, upon repayment of the 2023 Credit Agreement, or termination of the individual. The note bears interest at 10% per annum simple interest and has no conversion features. Interest is due at maturity. The June 2024 Subordinated Note is subordinated in right of payment to all current and future indebtedness of the Company for borrowed money. At June 30, 2024, \$20 was drawn against this subordinated note.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

Subordinated note interest expense for the three months ended June 30, 2024 and 2023 was \$0 and \$0, respectively, and for the six months ended June 30, 2024 and 2023 \$0 and \$0, respectively.

NOTE 9 – ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

	<u>June 30, 2024</u>	<u>December 31, 2023</u>
Accrued compensation	\$ 26	\$ 22
Vendor provided financing	-	142
Warranty and returns reserves	61	63
Accrued commissions	34	15
Amounts due customers	24	31
Accrued non-income-based taxes	17	20
Accrued interest	79	43
Other	<u>20</u>	<u>34</u>
Total accrued expenses and other current liabilities	<u>\$ 261</u>	<u>\$ 370</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 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 are exercisable no later than five (5) years after date of grant and vest either immediately or based upon graduated vesting schedules as determined by the Committee. The 2012 Plan terminated on June 21, 2022. On June 7, 2022, the Company’s Board of Directors approved and adopted, by unanimous written consent, an extension of the termination date of the Company’s 2012 Stock Incentive Plan for a period of one year, from June 21, 2022 to June 21, 2023. The Company’s shareholders approved the extension of the termination date to June 21, 2023 at the Company’s 2022 annual meeting of shareholders on August 4, 2022. On July 11, 2023, the Company’s Board of Directors approved and adopted, by unanimous written consent, an extension of the termination date of the Company’s 2012 Stock Incentive Plan for a period of one year, from June 21, 2023 to June 21, 2024. The Company’s shareholders approved the extension of the termination date to June 21, 2024 at the Company’s 2023 annual meeting of shareholders on August 22, 2023.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

As of June 30, 2024, 3,979,666 nonqualified stock options were outstanding under the 2012 Plan. 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 this plan is as follows:

	<u>Number</u>	<u>Weighted Average Exercise Price</u>
Options outstanding at December 31, 2023	4,621,666	\$ 0.32
Options granted	500,000	\$ 0.04
Options forfeited	(92,000)	\$ 0.10
Options expired	<u>(1,050,000)</u>	\$ 0.33
Options outstanding at June 30, 2024	<u>3,979,666</u>	\$ 0.29
Options exercisable	<u>2,474,166</u>	\$ 0.30
Shares available for granting of options	<u>8,325,353</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 and stock-based awards issued. Total stock compensation expense was \$41 and \$49 for the three months ended June 30, 2024 and 2023, respectively and \$82 and \$101 for the six months ended June 30, 2024 and 2023, respectively. No tax benefit was recognized for this compensation expense. At June 30, 2024, total unrecognized stock-based compensation expense is \$136, which has a weighted average period to be recognized of approximately 2.75 years. The Company has elected to recognize forfeitures as they occur.

The following table provides additional information regarding options outstanding as of June 30, 2024:

	Options Exercisable		Options Outstanding		Options Vested or Expected to Vest	
Option Exercise Price Range	Number Outstanding	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price	Number Outstanding	Weighted Average Exercise Price
\$0.04 to \$0.20	848,000	\$ 0.19	2,008,000	\$ 0.12	2,008,000	\$ 0.12
\$0.21 to \$0.40	1,301,666	\$ 0.30	1,541,666	\$ 0.28	1,541,666	\$ 0.28
\$0.41 to \$0.61	325,000	\$ 0.61	430,000	\$ 0.61	430,000	\$ 0.61
	<u>2,474,666</u>		<u>3,979,666</u>		<u>3,579,666</u>	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

	Options Exercisable	Options Outstanding	Options Vested or Expected to Vest
Weighted average years remaining term	1.0	1.3	1.3
Aggregate intrinsic value	\$ -	\$ -	\$ -

There were no stock options exercised in the first six months of 2024 and 2023.

NOTE 11 – LEASES

The Company determines whether an arrangement is a lease at inception and whether that lease meets the classification criteria of a finance or operating lease. Some of the Company's lease arrangements contain lease components (e.g., minimum rent payments) and non-lease components (real estate tax, maintenance, etc.). The Company leases its facility and certain office/plant equipment. The Company's facility lease has been determined to be an operating lease. For its facility lease, the Company accounts for lease components together with non-lease components.

Whenever the Company's leases do not provide an implicit interest rate, the Company uses its incremental borrowing rate, which is based on the lease term and adjusted for impacts of collateral, in determining the present value of lease payments.

At June 30, 2024, the Company's leases have remaining lease terms of 1.0 to 4.0 years, some of which include options to extend the lease for an additional 5-year term. The exercise of the lease renewal option is at the Company's discretion. Renewals to extend the lease term are not included in the Company's Right-of-use asset and Lease obligations as they are not reasonably certain of exercise. On October 13, 2022, the Company exercised its renewal option to extend the lease of its facility for an additional five (5) years for the period July 1, 2023 to June 30, 2028 at a base rent of \$17 per month. The Company's leases do not contain any material residual value guarantees or material restrictive covenants. Short-term lease expense is recognized on a straight-line basis over the term of the lease.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

The following table presents information about the amount, timing and cash flows arising from the Company's operating leases:

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2024</u>	<u>2023</u>	<u>2024</u>	<u>2023</u>
Components of lease cost:				
Operating lease cost	\$ 71	\$ 62	\$ 139	\$ 120
Variable lease cost	1	1	5	1
Short-term lease cost	2	3	5	6
Finance lease cost:				
Amortization of right-of-use asset	4	4	8	9
Interest	-	-	1	1
	<hr/>	<hr/>	<hr/>	<hr/>
Total	<u>\$ 78</u>	<u>\$ 70</u>	<u>\$ 158</u>	<u>\$ 147</u>

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2024</u>	<u>2023</u>	<u>2024</u>	<u>2023</u>
Operating lease cash flow information:				
Cash paid for amounts included in the measurement of operating lease liabilities	\$ 48	\$ 34	\$ 117	\$ 86
Finance lease cash information:				
Cash paid for amounts included in the measurement of finance lease liabilities	4	4	8	10
Non-cash activity:				
Right-of-use asset obtained in exchange for finance lease liability	-	-	-	-

	<u>June 30,</u>	
	<u>2024</u>	<u>2023</u>
Operating lease information:		
Weighted-average remaining operating lease term	48 months	60 months
Weighted-average operating lease discount rate	5.63%	5.63%
Operating lease amortization of right-of-use asset	\$ 105	\$ 105

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

Finance lease information:

Weighted-average remaining finance lease term	12 months	22 months
Weighted-average finance lease discount rate	3.49%	3.49%
Finance lease amortization of right-of-use asset	\$ 10	\$ 10

	June 30, 2024	
	<u>Operating leases</u>	<u>Finance leases</u>
Maturity of lease obligations:		
2024 (remaining)	\$ 141	\$ 10
2025	285	11
2026	289	1
2027	293	1
Thereafter	149	-
Total undiscounted lease payments	<u>1,157</u>	<u>23</u>
Less imputed interest	<u>(124)</u>	<u>(1)</u>
Present value of lease obligations	<u>\$ 1,033</u>	<u>\$ 22</u>

NOTE 12 – INCOME TAXES

For each interim reporting period, the Company makes an estimate of the effective tax rate it expects to be applicable for the full fiscal year for its operations. This estimated effective tax rate is used in providing for income taxes on a year-to-date basis. The Company's estimated effective tax rate through the first six months of fiscal 2024 and 2023 was 3.6% and differs from U.S. federal statutory rate due primarily to (i) the impact of valuation allowances against the Company's deferred tax assets and (ii) U.S. state and local income taxes.

NOTE 13 – SUBSEQUENT EVENTS

The Company evaluated its June 30, 2024 financial statements for subsequent events through September 30, 2024, the date the financial statements were available to be issued. On September 20, 2024, the Company's Board of Directors approved a \$40,000 unsecured subordinated loan from a Board member. The note matures on the sooner of July 27, 2025 or when the Company's senior line of credit is repaid. The note bears interest at 10% per annum. The note does not have a conversion feature. The Company is not aware of any other subsequent events which would require recognition or disclosure in the consolidated financial statements.