SPAR GROUP INC
Form 10-Q
August 13, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the second quarterly period ended **June 30, 2013.**

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from __________ to __________.

Commission file number: 0-27824

SPAR Group, Inc.
(Exact name of registrant as specified in its charter)

Delaware	33-0684451
State of Incorporation	IRS Employer Identification No.

333 Westchester Avenue, South Building, Suite 204,
White Plains, New York 10604
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (914) 332-4100

Indicate by check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. (See the definitions of "large accelerated filer", "accelerated filer", "non-accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer	Smaller Reporting Company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

On June 30, 2013, there were 20,487,318 shares of Common Stock outstanding.

SPAR Group, Inc.

Index

PART I: FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

SPAR Group, Inc. and Subsidiaries

Consolidated Balance Sheets

(In thousands, except share and per share data)

	June 30, 2013 (unaudited)	**December 31, 2012 (note)**
Assets		
Current assets:		
Cash and cash equivalents	**$ 3,051**	$ 1,792
Accounts receivable, net	**19,709**	21,414
Deferred tax	**180**	194
Prepaid expenses and other current assets	**577**	596
Total current assets	**23,517**	23,996
Property and equipment, net	**1,991**	1,777
Goodwill	**1,792**	1,792
Intangibles	**2,539**	1,468
Other assets	**340**	237
Total assets	**$ 30,179**	$ 29,270
Liabilities and equity		
Current liabilities:		
Accounts payable	**$ 5,006**	$ 4,177
Accrued expenses and other current liabilities	**6,229**	6,729
Accrued expenses due to affiliates	**1,318**	705
Customer deposits	**445**	263
Lines of credit	**2,269**	2,393
Total current liabilities	**15,267**	14,267
Long-term debt and other liabilities	**150**	268
Total liabilities	**15,417**	14,535
Equity:		

SPAR Group, Inc. equity		
Preferred stock, $.01 par value: Authorized and available shares– 2,445,598 Issued and outstanding shares – none – June 30, 2013 and none – December 31, 2012	**–**	–
Common stock, $.01 par value: Authorized shares – 47,000,000 Issued and outstanding shares – 20,487,318 – June 30, 2013 and 20,456,453 – December 31, 2012	**205**	205
Treasury stock	**(107)**	(26)
Additional paid-in capital	**15,014**	14,738
Accumulated other comprehensive loss	**(943)**	(382)
Accumulated deficit	**(1,783)**	(1,696)
Total SPAR Group, Inc. equity	**12,386**	12,839
Non-controlling interest	**2,376**	1,896
Total liabilities and equity	**$ 30,179**	$ 29,270

Note: The Balance Sheet at December 31, 2012, is excerpted from the consolidated audited financial statements as of that date but does not include certain information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

See accompanying notes.

SPAR Group, Inc. and Subsidiaries

Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income

(unaudited)

(In thousands, except per share data)

	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Net revenues	**$28,696**	$24,343	**$54,873**	$45,390
Cost of revenues	**21,883**	17,635	**42,028**	32,913
Gross profit	**6,813**	6,708	**12,845**	12,477
Selling, general and administrative expenses	**6,135**	5,634	**11,507**	10,655
Depreciation and amortization	**409**	293	**711**	570
Operating income	**269**	781	**627**	1,252
Interest expense	**20**	12	**51**	63
Other (income) expense	**(60)**	75	**(73)**	(7)
Income before provision for income taxes	**309**	694	**649**	1,196
Provision for income taxes	**250**	58	**378**	101
Net income	**59**	636	**271**	1,095
Net (income) loss attributable to the non-controlling interest	**(189)**	82	**(358)**	(70)
Net (loss) income attributable to SPAR Group, Inc.	**$(130)**	$718	**$(87)**	$1,025
Basic/diluted net income per common share:				
Net (loss) income - basic	**$(0.01)**	$0.04	**$-**	$0.05
Net (loss) income - diluted	**$(0.01)**	$0.03	**$-**	$0.05
Weighted average common shares – basic	**20,481**	20,134	**20,473**	20,125
Weighted average common shares – diluted	**21,716**	21,495	**21,661**	21,609

Net income	**59**	636	**271**	1,095
Other comprehensive loss:				
Foreign currency translation adjustments	**(363)**	(153)	**(561)**	(195)
Comprehensive (loss) income	**$(304)**	$483	**$(290)**	$900

See accompanying notes.

SPAR Group, Inc. and Subsidiaries

Consolidated Statement of Equity

(unaudited)

(In thousands)

	Common Stock							
	Shares	**Amount**	**Treasury Stock**	**Paid-In Capital**	**Accumulated Deficit**	**Accumulated Other** Comprehensive Loss	**Non-** Controlling Interest	**Total Equity**
Balance at January 1, 2013	20,456	$ 205	$ (26)	$ 14,738	$ (1,696)	$ (382)	$ 1,896	$ 14,735
Issuance of stock options and restricted shares to employees & non- employees for services	20	–	–	256	–	–	–	256
Exercise of stock options	52	–	–	20	–	–	–	20
Purchase of non-controlling interest in joint venture	–	–	–	–	–	–	18	18
Other changes to non-controlling interest	–	–	–	–	–	–	104	104
Purchase of treasury shares	(43)	–	(85)	–	–	–	–	(85)
Re-issued treasury shares	2	–	4	–	–	–	–	4
Other comprehensive loss	–	–	–	–	–	(561)	–	(561)
Net income	–	–	–	–	(87)	–	358	271
Balance at June 30, 2013	**20,487**	**$ 205**	**$ (107)**	**$ 15,014**	**$ (1,783)**	**$ (943)**	**$ 2,376**	**$ 14,762**

See accompanying notes.

SPAR Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(unaudited)

(In thousands)

	Six Months Ended June 30,	
	2013	**2012**
Operating activities		
Net income	**$271**	$1,095
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	**711**	570
Bad debt, net	**28**	17
Share based compensation	**256**	277
Changes in non-controlling interest	**122**	39
Changes in operating assets and liabilities:		
Accounts receivable	**1,641**	(1,910)
Prepaid expenses and other assets	**(70)**	17
Accounts payable	**829**	1,401
Accrued expenses, other liabilities and customer deposits	**567**	1,656
Net cash provided by operating activities	**4,355**	3,162
Investing activities		
Purchases of property, equipment and capitalized software	**(731)**	(448)
Purchase of MFI business	**(1,300)**	-
Purchase of India Preceptor Subsidiary	**(21)**	-
Final payment for the purchase of NMS, LLC	**(200)**	-
Net cash used in investing activities	**(2,252)**	(448)
Financing activities		
Net payments on lines of credit	**(118)**	(2,399)
Proceeds from options exercised	**20**	8
Payments on term debt	**(14)**	(18)
Payments on capital lease obligations	**(116)**	(107)
Purchase of treasury shares	**(85)**	-
Net cash used in financing activities	**(313)**	(2,516)
Effects of foreign exchange rate on cash	**(531)**	(181)
Net change in cash and cash equivalents	**1,259**	17
Cash and cash equivalents at beginning of period	**1,792**	1,705

Cash and cash equivalents at end of period	**$3,051**	$1,722
Supplemental disclosure of cash flows information		
Interest paid	**$68**	$88
Taxes paid	**$175**	$81
Supplemental disclosure of non-cash financing activities		
Acquisition of equipment through capital leases	**$-**	$253

See accompanying notes.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

1. Basis of Presentation

The accompanying unaudited, consolidated financial statements of SPAR Group, Inc., a Delaware corporation ("SGRP"), and its subsidiaries (together with SGRP, collectively, the "Company" or the "SPAR Group") have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included in these interim financial statements. However, these interim financial statements should be read in conjunction with the annual consolidated financial statements and notes thereto for the Company as contained in the SGRP's Annual Report for 2012 on Form 10-K for the year ended December 31, 2012, as filed with the Securities and Exchange Commission (the "SEC") on April 2, 2013 (the "2012 Annual Report"), and SGRP's Proxy Statement for its 2013 Annual Meeting of Stockholders as filed with the SEC on April 19, 2013 (the "2013 Proxy Statement"). The Company's results of operations for the interim periods are not necessarily indicative of its operating results for the entire year.

2. Business and Organization

The SPAR Group is a supplier of merchandising and other marketing services throughout the United States and internationally. The Company also provides in-store event staffing, in-store audit service, product sampling, furniture and other product assembly services, technology services and marketing research services. Assembly services are performed in stores, homes and offices while those other services are primarily performed in mass merchandisers, office supply, grocery, drug store, independent, convenience and electronics stores.

Merchandising services primarily consist of regularly scheduled, special project and other product services provided at the store level, and the Company may be engaged by either the retailer or the manufacturer. Those services may include restocking and adding new products, removing spoiled or outdated products, resetting categories "on the shelf" in accordance with client or store schematics, confirming and replacing shelf tags, setting new sale or promotional product displays and advertising, replenishing kiosks, providing in-store event staffing and providing assembly services in stores, homes and offices. Other merchandising services include whole store or departmental product sets or resets, including new store openings, new product launches and in-store demonstrations, special seasonal or promotional merchandising, focused product support and product recalls.

As of June 30, 2013 the Company operates in 10 countries that encompass approximately 50% of the total world population. Although it operates in a single business segment (merchandising and marketing services), the Company currently divides its operations for marketing, administrative and other purposes into two geographic divisions: its Domestic Merchandising Services Division, which provides those services in the United States of America since certain of its predecessors were formed in 1979; and its International Merchandising Services Division, which began operations in May of 2001 and provides similar merchandising, marketing services and in-store event staffing services in Japan, Canada, South Africa, India, Romania, China, Australia, Mexico and Turkey. The Company continues to focus on expanding its merchandising and marketing services business throughout the world.

Please see PART I: FINANCIAL INFORMATION, Item 2 - Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources - *GENERAL* (including *An Overview of the Merchandising and Marketing Services Industry* and *The Company's Domestic and International Geographic Divisions*), and Note 12 -- *Geographic Data*, below.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

3. Earnings Per Share

The following table sets forth the computations of basic and diluted earnings per share (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	**2013**	2012
Numerator:				
Net (loss) income attributable to SPAR Group, Inc.	**$(130)**	$718	**$(87)**	$1,025
Denominator:				
Shares used in basic net income per share calculation	**20,481**	20,134	**20,473**	20,125
Effect of diluted securities:				
Employee stock options	**1,235**	1,361	**1,188**	1,484
Shares used in diluted net income per common share calculation	**21,716**	21,495	**21,661**	21,609
Basic net (loss) income per common share	**$(0.01)**	$0.04	**$-**	$0.05
Diluted net (loss) income per common share	**$(0.01)**	$0.03	**$-**	$0.05

4. Credit Facilities

The Company is a party to various domestic and international credit facilities. See PART I: FINANCIAL INFORMATION, Item 2 - Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources, below.

Summary of Company Credit and Other Debt Facilities: (in thousands)

Credit Facilities	**June 30, 2013**	**Average Interest Rate**	December 31, 2012	Average Interest Rate
Loan Balance:				
United States	**$2,269**	**3.3 %**	$ 1,762	4.3 %
Australia	**-**	**-**	210	9.4 %
Canada	**-**	**-**	421	4.0 %
	$2,269		$ 2,393	
Other Debt Facility:				
Japan Term Loan	**$135**	**0.1 %**	$ 171	0.1 %

	June 30, 2013	December 31, 2012
Unused Availability:		
United States	**$2,515**	$ 4,248
Australia	**1,098**	1,035
Canada	**713**	331
	$4,326	$ 5,614

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

5. Capital Lease Obligations

The Company has four outstanding capital lease obligations with interest rates ranging from 4.5% to 7.0%. The related capital lease assets balances are detailed below (in thousands):

Start Date:	Original Cost	Accumulated Amortization	Net Book Value at June 30, 2013
November, 2010	$ 48	$ 43	$ 5
June, 2011	140	97	43
January, 2012	224	112	112
January, 2012	29	14	15
	$ 441	$ 266	$ 175

Annual future minimum lease payments required under the leases, together with the present value as of June 30, 2013, are as follows (in thousands):

Year Ending December 31,	Amount
2013	$ 79
2014	113
Less amount representing interest	10
Present value of net minimum lease payments included with other liabilities	$ 182

6. Related-Party Transactions

SGRP's policy respecting approval of transactions with related persons, promoters and control persons is contained in the SPAR Group Code of Ethical Conduct for its Directors, Senior Executives and Employees Amended and Restated (as of) August 1, 2012 (the "Ethics Code"). Article V of the Ethics Code generally prohibits each "Covered Person" (including SGRP's officers and directors) from engaging in any business activity that conflicts with his or her duties to the Company, and directs each "Covered Person" to avoid any activity or interest that is inconsistent with the best interests of the SPAR Group, in each case except for any "Approved Activity" (as such terms are defined in the Ethics Code). Examples of violations include (among other things) having any ownership interest in, acting as a director or officer of or otherwise personally benefiting from business with any competitor, customer or vendor of the Company other than pursuant to any Approved Activity. Approved Activities include (among other things) any contract with an affiliated person (each an "Approved Affiliate Contract") or anything else disclosed to and approved by SGRP's Board of Directors (the "Board"), its Governance Committee or its Audit Committee, as the case may be, as well as the ownership, board, executive and other positions in SMS, SMSI, SIT, NMA and others (as defined and described below) held by certain directors, officers or employees of SGRP or their family members. The Company's senior management is generally responsible for monitoring compliance with the Ethics Code and establishing and maintaining compliance systems, including conflicting relationships and transactions, subject to the review and oversight of SGRP's Governance Committee as provided in clause IV.11 of the Governance Committee's Charter, and SGRP's Audit Committee as provided in clause I.2(l) of the Audit Committee's Charter. The Governance Committee and Audit Committee each consist solely of independent outside directors.

SGRP's Audit Committee has the specific duty and responsibility to review and approve the overall fairness of all material related-party transactions. The Audit Committee receives every affiliate contract and amendment thereto for its review and approval (to the extent approval is given), and each contract is periodically (often annually) again reviewed, in accordance with the Audit Charter, the Ethics Code, the rules of the Nasdaq Stock Market, Inc. ("Nasdaq"), and other applicable law to ensure that the overall economic and other terms will be (or continue to be) no less favorable to the Company than would be the case in an arms-length contract with an unrelated provider of similar services (i.e., its overall fairness). The Audit Committee periodically reviews all related party relationships and transactions described below and as of this Quarterly report the parties are in compliance with these agreements.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

Mr. Robert G. Brown, a Director, the Chairman and a major stockholder of SGRP, and Mr. William H. Bartels, a Director and the Vice Chairman of the Company and a major stockholder of SGRP, are the sole stockholders of SPAR Marketing Services, Inc. ("SMS") and SPAR Management Services, Inc. ("SMSI"). Mr. Brown is the sole stockholder of SPAR InfoTech, Inc. ("SIT"). Mr. Brown is a director and officer of SMS and SIT. Mr. Bartels is a director and officer of SMSI.

SMS and SMSI provided approximately 99% of the domestic merchandising specialist field force used by the Company (other than NMS, as defined below) for both the six months ended June 30, 2013 and 2012 and approximately 94% and 93% of the domestic field management used by the Company at a total cost of approximately $11.3 million and $12 million for the six months ended June 30, 2013 and 2012, respectively. Pursuant to the terms of the Amended and Restated Field Service Agreement dated as of January 1, 2004, as amended, in 2013 the Company received merchandising services from SMS through the use of approximately 7,800 field merchandising specialists. SMS also furnished (without charge) 240 handheld computers used by field merchandising specialists in the performance of various merchandising and marketing services in the United States, which the Company estimates has an aggregate value of approximately $2,000 to $3,000 per month. Pursuant to the terms of the Amended and Restated Field Management Agreement dated as of January 1, 2004, in 2013 the Company received administrative services from SMSI through the use of 60 full-time national, regional and district administrators. For those services, the Company has agreed to reimburse SMS and SMSI for their total costs of providing those services and to pay SMS and SMSI each a fee equal to 4% of their respective total costs (the "Plus 4 % Compensation"). Those costs include all field expenses of SMS, all payroll and employment tax expenses of SMSI and all legal and other administrative expenses paid by either of them as well as the lease expense of the handheld computers referred to above. The net total Plus 4% Compensation earned by SMS and SMSI for services rendered was approximately $436,000 and $456,000 for the six months ended June 30, 2013 and 2012, respectively. The Company also provides certain administrative services directly to SMS and SMSI, without charge, for accounting (in 2012 only), human resource and legal services, which the Company believes is more efficient if paid directly, and would otherwise have been subject to cost plus reimbursement. The value of these services for the six months ended June 30, 2013 and 2012 was approximately $229,000 and $304,000, respectively. The Company charged SMS and SMSI $75,000 for accounting services for the six months ended June 30, 2013. Those service agreements with SMS and SMSI are currently scheduled to automatically renew on December 31, 2013, and are being renegotiated.

No salary reimbursements for Mr. Brown or Mr. Bartels are included in such reimbursable costs or Plus 4% Compensation. However, since SMS and SMSI are "Subchapter S" corporations and are owned by Messrs. Brown and Bartels, all income from SMS and SMSI is allocated to them.

National Merchandising Services, LLC ("NMS"), is a consolidated domestic subsidiary of the Company and is owned jointly by SGRP through its indirect ownership of 51% of the NMS membership interests and by National Merchandising of America, Inc. ("NMA"), through its ownership of the other 49% of the NMS membership interests. (See Note 11 to the Consolidated Financial Statements - *Purchase of Interests in Subsidiaries*, below.) Mr. Edward Burdekin is the Chief Executive Officer and President and a director of NMS and also is an executive officer and director of NMA. Ms. Andrea Burdekin, Mr. Burdekin's wife, is the sole stockholder and a director of NMA and a director of NMS.

NMA is expected to provide substantially all of the domestic merchandising specialist field force used by NMS. Pursuant to the terms of the Field Services Agreement dated as of July 31, 2012, as amended (the "NMA Services Agreement"), NMS will receive merchandising services from NMA through the use of approximately 1,100 field merchandising specialists. For those services, the Company has agreed to reimburse NMA for its total costs of providing those services and to pay NMA a fee equal to 2% of its total costs (the "Plus 2% Compensation"). Those costs include all field expenses, payroll and employment tax expenses of NMA but exclude certain field merchandiser taxes and legal and other administrative expenses. Accordingly, no salary reimbursement for Mr. Burdekin or Ms. Burdekin are included in such reimbursable costs or Plus 2% Compensation.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

NMS commenced operations as of September 1, 2012. NMA provided all of the domestic merchandising specialist field force used by NMS and 12% of the total domestic merchandising specialist field force used by the Company (including NMS) for the six months ended June 30, 2013. The total Plus 2% Compensation earned by NMA for services rendered was approximately $22,000 for the six months ended June 30, 2013.

In connection with the approval of those related party agreements with NMA, the Board approved, based (in part) on the recommendation and approval of its Governance Committee (which is comprised solely of independent directors), the restated Ethics Code. As a result, the newly approved NMA Field Services Agreement is, and the previously approved affiliate contracts (See "Transactions with Related Persons, Promoters and Certain Control Persons" in SGRP's 2013 Proxy Statement) continue to be, exempted from various conflict prohibitions in the Ethics Code. The Ethics Code changes were not intended to substantively alter the code's existing prohibitions and exceptions applicable to the directors and executive officers of SGRP.

The Company continues to purchase services from SMS, SMSI and NMA because it believes the value of services it receives from them are at least as favorable to the Company as it could obtain from non-affiliated providers of similar services. The Company believes it is the largest and most important customer of SMS, SMSI and NMA (and from time to time may be their only customer), and accordingly the Company is able to negotiate better terms, receives more personal and responsive service and is more likely to receive credits and other financial accommodations from SMS, SMSI and NMA than the Company could reasonably expect to receive from an unrelated service provider who has significant other customers and business. The Company periodically evaluates these fees and rates charged by comparable national labor sourcing firms to serve as a comparison to the rates charged by SMS, SMSI and NMA. The most recent such survey showed that the rates negotiated with SMS, SMSI and NMA are in fact slightly less than those charged by unrelated vendors providing similar services. Based on an analysis performed by management, the Company believes that its cost of revenue would have increased by at least $329,000 and $360,000 for the six months ended June 30, 2013 and 2012, respectively, if the Company would have instead used an unaffiliated entity to provide comparable services. All affiliate contracts are reviewed and approved by SGRP's Audit Committee, as described above. See also *Dependence Upon and Cost of Services Provided by Affiliates and Potential Conflicts in Services Provided by Affiliates* in Item 1A (Risk Factors) in SGRP's 2012 Annual Report.

The following transactions occurred between the Company and the above affiliates (in thousands):

	Three Months Ended June	Six Months Ended June 30,

	30, 2013	2012	**2013**	2012
Services provided by affiliates:				
Field merchandiser services (SMS)	**$4,776**	$5,150	**$8,887**	$9,759
Field management services (SMSI)	**$1,460**	$1,180	**$2,440**	$2,269
Field merchandiser services (NMA)	**$564**	$-	**$1,105**	$-
Total services provided by affiliates	**$6,800**	$6,330	**$12,432**	$12,028

Accrued expenses due to affiliates :	**June 30, 2013**	December 31, 2012
Total accrued expenses due to affiliates	**$1,318**	$ 705

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

In July 1999, SMF, SMS and SIT entered into a perpetual software ownership agreement providing that each party independently owned an undivided share of and had the right to unilaterally license and exploit their "Business Manager" Internet job scheduling software (which had been jointly developed by such parties), and all related improvements, revisions, developments and documentation from time to time voluntarily made or procured by any of them at its own expense. In addition, SPAR Trademarks, Inc. ("STM"), SMS and SIT entered into separate perpetual trademark licensing agreements whereby STM has granted non-exclusive royalty-free licenses to SIT and SMS (and through them to their commonly controlled subsidiaries and affiliates by sublicenses, including SMSI) for their continued use of the name "SPAR" and certain other trademarks and related rights of STM, a wholly owned subsidiary of SGRP. SMS and SMSI provide services to the Company, as described above, and SIT no longer provides services to and does not compete with the Company.

Through arrangements with the Company, SMS, SMSI and other companies owned by Mr. Brown or Mr. Bartels participate in various benefit plans, insurance policies and similar group purchases by the Company, for which the Company charges them their allocable shares of the costs of those group items and the actual costs of all items paid specifically for them. All such transactions between the Company and the above affiliates are paid and/or collected by the Company in the normal course of business. As an accommodation, the Company also provides certain accounting, human resource and similar administrative services to SIT and certain other affiliates of Robert G. Brown and William H. Bartels, at a nominal cost.

In addition to the above, SMSI purchases insurance coverage for worker compensation, casualty and property insurance risk for itself, SMS and (through SMS under contracts with them) it's field merchandising specialists, and the Company from Affinity Insurance, Ltd. ("Affinity"). SMSI owns minority (less than 1%) equity interest in Affinity, and Robert G. Brown is a director of Affinity. The Affinity insurance premiums for such coverage are ultimately charged to SMSI, SMS (and through SMS to its covered field merchandising specialists) and the Company based on the contractual arrangements of the parties.

In the event of any material dispute in the business relationships between the Company and SMS, SMSI, SIT or NMA, it is possible that Mr. Brown, Mr. Bartels or Mr. Burdekin may have one or more conflicts of interest with respect to these relationships and such dispute could have a material adverse effect on the Company.

7. Preferred Stock

SGRP's certificate of incorporation also authorizes it to issue 3,000,000 shares of preferred stock with a par value of $0.01 per share (the "SGRP Preferred Stock"), which may have such preferences and priorities over the SGRP Common Stock and other rights, powers and privileges as the Company's Board of Directors may establish in its discretion from time to time. The Company has created and authorized the issuance of a maximum of 3,000,000 shares of Series A Preferred Stock pursuant to SGRP's Certificate of Designation of Series "A" Preferred Stock (the "SGRP Series A Preferred Stock"), which have dividend and liquidation preferences, have a cumulative dividend of 10% per year, are redeemable at the Company's option and are convertible at the holder's option (and without further consideration) on a one-to-one basis into SGRP Common Stock. As of June 30, 2013 there are 2,445,598 shares of SGRP Series A Preferred Stock authorized and available for issuance under SGRP's certificate of incorporation and Certificate of Designation of Series "A" Preferred Stock. The number of shares authorized by such designation could, however, be reduced by amendment or redemption to facilitate the creation of other SGRP Preferred Series.

8. Stock-Based Compensation and Other Plans

SGRP currently grants options to its eligible directors, officers and employees and certain employees of its affiliates to purchase shares of Common Stock issued by SGRP ("SGRP Shares") pursuant to the 2008 Stock Compensation Plan (as amended, the "2008 Plan"). SGRP also has granted stock options that continue to be outstanding under various predecessor stock option plans (each a "Prior Plan"). The Prior Plans consist of the following: the Amended and Restated 1995 Stock Option Plan (the "1995 Plan"); and the 2000 Stock Option Plan ("2000 Plan"), which succeeded the 1995 Plan. Each Prior Plan will continue to be outstanding for the purposes of any remaining outstanding options issued under it for so long as such options are outstanding. As described below, SGRP also has the authority to issue other types of stock-based awards under the 2008 Plan, but to date has only issued restricted stock in addition to such options.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

The 2008 Plan limits the number of SGRP Shares that may be covered by Awards ("Outstanding Covered Shares") to 5,600,000 SGRP Shares in the aggregate (the "Maximum Covered Shares"). The stock options issued under the 2008 Plan are typically "nonqualified" (as a tax matter), have a ten (10) year maximum life (term) and vest during the first four years following issuance at the rate of 25% on each anniversary date of their issuance. SGRP has the authority to issue other types of stock-based awards under the 2008 Plan, but to date has only issued restricted stock in addition to stock options. The Company accounts for its employee and affiliate employee stock option expense as compensation expense in the Company's consolidated financial statements when the stock options are granted, as now required by applicable accounting principles. Share-based compensation cost is measured on the grant date, based on the fair value of the award calculated at that date, and is recognized over the requisite service period, which generally is the options' vesting period. Fair value is calculated using the Black-Scholes option pricing model. For a more detailed description of the 2008 Plan, please see *Stock Compensation Plans* on pages 20-22 in SGRP's Proxy Statement for its 2013 Annual Meeting of Stockholders as filed with the SEC on April 19, 2013.

Based upon the Black-Scholes calculation, share-based compensation expense related to employee and non-employee stock option grants totaled $227,200 and $220,000 for the six months ended June 30, 2013 and 2012, respectively. The unamortized expense as of June 30, 2013, was approximately $740,000 for outstanding stock option grants. The impact of the total share-based compensation expense on basic/diluted earnings per share was approximately one cent for both the six months ended June 30, 2013 and 2012.

During the six months ended June 30, 2013, new stock option grants covering 68,000 SGRP Shares were awarded. One outside director was awarded 10,000 at an exercise price of $1.51 per share and three outside directors were awarded 30,000 at an exercise price of $1.81 per share. Seven new employees of the Company and SMSI were awarded 28,000 at an exercise price between $1.50 and $1.68 per share which represents the fair market value of a SGRP Share. The unamortized expense for these option grants was approximately $95,000 as of June 30, 2013.

Pursuant to the 2008 Plan, SGRP's Compensation Committee authorized a restricted SGRP common stock award of 100,000 shares on March 10, 2011 (the "2011 RS Award"), and 25,000 shares on August 1, 2012 (the "2012 RS Award"), as additional compensation to Mr. Raymond, the Company's Chief Executive Officer and President. The restricted shares vest in five equal parts on each of the five anniversaries following the award date (20,000 shares a year in the case of the 2011 RS Award, which started to vest on March 10, 2012, and 5,000 shares a year in the case of the 2012 RS Award, which starts to vest on August 1, 2013), so long as Mr. Raymond continues to be so employed by the Company on the applicable vesting date. If Mr. Raymond leaves such employment, he will lose his right to receive any unvested shares. The compensation expense related to each such award will be amortized by the Company over the five (5) year vesting periods, starting on the issuance date of each award (March 10, 2011, and August 1, 2012, respectively). The Company recorded compensation expenses for the six months ended June 30, 2013, of

$26,500 for the 2011 RS Award and $2,300 for the 2012 RS Award. The unamortized expense as of June 30, 2013 was approximately $128,000 for the 2011 RS Award and $23,000 for the 2012 RS Award.

In 2001, SGRP adopted its 2001 Employee Stock Purchase Plan (the "ESP Plan"), which replaced its earlier existing plan, and its 2001 Consultant Stock Purchase Plan (the "CSP Plan"). These plans were each effective as of June 1, 2001. The ESP Plan allows employees of the Company, and the CSP Plan allows employees of the affiliates of the Company (See Note 6 - *Related Party Transactions*, above), to purchase SGRP's Common Stock from SGRP without having to pay any brokerage commissions. On August 8, 2002, SGRP's Board approved a 15% discount for employee purchases of Common Stock under the ESP Plan and recommended that its affiliates pay 15% of the value of the stock purchased as a cash bonus for affiliate consultant purchases of Common Stock under the CSP Plan. The maximum amount that any employee or consultant can contribute to those plans per quarter is $6,250 and the total number of shares reserved by the Company for purchase under those purchase plans is 500,000. Shares purchased by employees and consultants under those purchase plans were 1,679 for the six month period ended June 30, 2013. The Company's expense resulting from the 15% discount offered to employees and consultants was immaterial for all years presented. For more information respecting the Company's stock option and compensation plans, please see "*Stock Compensation Plans*" in the Company's 2013 Proxy Statement.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

9. Customer Deposits

Customer deposits at June 30, 2013, were $445,000 ($255,000 from domestic operations and $190,000 from international operations) compared to $263,000 at December 31, 2012 ($176,000 from domestic operations and $87,000 from international operations).

10. Commitments and Contingencies

Legal Matters

The Company is a party to various legal actions and administrative proceedings arising in the normal course of business. See PART II: OTHER INFORMATION, Item 1 - *Legal Proceedings*, below.

11. Purchase of Interests in Subsidiaries

The following contains descriptions of the Company's purchases of interests in its operating subsidiaries during the six month period ended June 30, 2013. In each of the subsidiaries noted below the Company, through its various agreements with the applicable Local Investor, has provided for appropriate exit strategies that are fair and equitable for each partner. The terms "Global Contributions", "Local Investor" and "Local Contributions" are used in those purchase descriptions as such terms are described and defined in Item 1 - *Acquisition Strategies and Strategic Acquisitions* in the Company's 2012 Annual Report.

BIP (Romania)

In May 2012, the Company finalized the purchase (effective as of April 1, 2012), for $60,000, of 51% ownership in Business Ideas Provider GRUP SRL ("BIP"), a Romanian limited liability company in Bucharest, Romania, which became a consolidated subsidiary of the Company. The Company purchased a majority (51%) of the equity interests in BIP and is providing its usual Global Contributions, while Business Ideas Provider SRL as the Local Investor owns the remaining minority (49%) non-controlling interest in BIP and is providing the usual Local Contributions. The fair market value of the stock purchased by the Company was approximately $79,000; therefore the Company recorded a gain of $19,000 on the acquisition.

The following table includes the amount of BIP's revenue and earnings included in the Company's consolidated income statement for the six months ended June 30, 2013 and a *pro forma* calculation of the amounts of BIP's revenue and earnings that would have been included in the Company's consolidated income statement for the six months ended June 30, 2012, had the BIP acquisition date been January 1, 2012, instead of as of April 1, 2012 (in thousands):

	Revenue	Net Income
Actual BIP from January 1 to June 30, 2013	$2,474	$41
2013 consolidated from January 1 to June 30, 2013	$54,873	$(87)
2012 consolidated supplemental pro forma from January 1 to June 30, 2012	$46,659	$1,000

<u>NMS (USA)</u>

In September 2012, the Company made a domestic acquisition that also used its international strategy of seeking a minority (*i.e.*, non-controlling) non-affiliated Local Investor for the Company's new consolidated subsidiary in Georgia, U.S.A. As with most of its international counterparts, the Company acquired a 51% interest in National Merchandising Services, LLC, a newly formed Nevada limited liability company ("NMS"), and is providing its usual Global Contributions, and since then NMS has been a part of the Company's consolidated financial reports. NMS provides merchandising services in the U.S.A. to multiple Fortune 500 companies previously supplied by its Local Investor. The Local Investor in this case is National Merchandising of America, Inc., a Georgia corporation ("NMA"), which owns a 49% interest in NMS and will provide field merchandising services to NMS pursuant to a Field Services Agreement with NMS. In addition, NMA contributed substantially all of its customers to NMS and is providing the usual Local Contributions.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

The Company's total investment in NMS is $859,050, which consists of the following (1) $510 in capital, (2) a cash payment of $400,000 to NMA and a $200,000 non-interest bearing promissory note paid on January 2, 2013, (3) issuance of SPAR common stock worth $165,000 to NMA, and (4) a contingent liability of $93,540 described below.

NMS agreed to pay an incentive consulting fee ("Consulting Fee") to NMA based on NMS achieving certain earnings goals in each of the next three 12 month periods. The Consulting Fee is calculated based on 50% of NMS earnings in excess of the annual base earnings of $500,000. The maximum consideration for the Consulting Fee could be as much as $600,000. The projected consulting fee is approximately $93,540 and has been recorded as a contingent liability at December 31, 2012 and June 30, 2013. The Company has completed its valuation of the fair value and related allocation between identifiable intangibles and goodwill, and recorded the following in 2012. The intangible asset is being amortized over ten years. The amortization expense was $26,316 for the six months ended June 30, 2013.

Intangible asset	$526,320
Goodwill	332,730
	$859,050

The following table includes the amount of NMS's revenue and earnings included in the Company's consolidated income statement for the six months ended June 30, 2013 and a *pro forma* calculation of the amounts of NMS's revenue and earnings that would have been included in the Company's consolidated income statement for the six months ended June 30, 2012, had the NMS acquisition date been January 1, 2012, instead of as of September, 2012 (in thousands):

	Revenue	Net Income
Actual NMS from January 1 to June 30, 2013	$1,528	$226
2013 consolidated from January 1 to June 30, 2013	$54,873	$(87)
2012 consolidated supplemental pro forma from January 1 to June 30, 2012	$46,482	$1,145

<u>CMR-Meridian (South Africa)</u>

In September 2012, the Company's existing local consolidated subsidiary, SGRP Meridian (Pty) Ltd. ("SGRP Meridian"), acquired a majority (51%) of the equity interests in CMR Meridian (Pty) Ltd. ("CMR-Meridian"). Combined Manufacturers National (Pty) Ltd ("CMR") acquired the remaining minority (49%) non-controlling interest in CMR-Meridian as its Local Investor, contributed substantially all of its customers to CMR-Meridian and provided the usual Local Contributions while the Company is providing its usual Global Contributions. SGRP Meridian and CMR-Meridian are both are part of the Company's consolidated financial reports.

CMR-Meridian initiated operations on October 1, 2012 and the Company provided approximately $380,000 in a working capital loan to assist SGRP Meridian in this new joint venture. SGRP Meridian, through the joint venture agreement with CMR, paid approximately $73,000 at closing and recorded a contingent liability in the amount of $154,000 respecting the fair value of potential future payments required to be made by SGRP Meridian to CMR provided certain financial conditions are achieved by CMR-Meridian in 2013 and 2014. The required payments based on an exchange rate of Rand to US Dollars at June 30, 2013, are as follows: (a) $69,000 if CMR-Meridian achieves $228,000 of earnings before interest and taxes for the twelve month period ending December 31, 2013; and (b) $92,000 if CMR-Meridian achieves $228,000 of earnings before interest and taxes for the twelve month period ending December 31, 2014. If during these two periods the earnings before interest and taxes is lower than $228,000 the payment in each year will be reduced proportionately.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

In addition to the above payments, CMR-Meridian may be required to pay CMR an Incentive Consulting Fee provided CMR-Meridian meets the following financial criteria. Should CMR-Meridian's earnings before interest and taxes exceed $228,000 in each of the following twelve month periods ending December 31, CMR-Meridian will pay to CMR:

For 2013, the payment will be 50% of the excess earnings up to a maximum of $159,000,

For 2014, the payment will be 25% of the excess earnings up to a maximum of $93,000, and

For 2015, the payment will be 10% of the excess earnings up to a maximum of $44,000.

At the end of the first three full years of operations, an additional bonus of $57,000 will be paid by CMR-Meridian to CMR if the combined cumulative earnings before interest and taxes exceed $684,000 provided that in each year, a minimum $228,000 in earnings is achieved. Based on current projections, the Company does not believe at this time that CMR-Meridian will meet the criteria to earn the Incentive Consulting Fee, therefore no contingent liability has been recorded as of December 31, 2012 or June 30, 2013. However, the Company will continue to evaluate the potential for the Incentive Consulting Fee throughout 2013.

The following table includes the amount of CMR's revenue and earnings included in the Company's consolidated income statement for the six months ended June 30, 2013 and a *pro forma* calculation of the amounts of CMR's revenue and earnings that would have been included in the Company's consolidated income statement for the six months ended June 30, 2012, had the CMR acquisition date been January 1, 2012, instead of as of September, 2012 (in thousands):

	Revenue	Net Income
Actual CMR from January 1 to June 30, 2013	$ 3,902	$ 1
2013 consolidated from January 1 to June 30, 2013	$ 54,873	$ (87)
2012 consolidated supplemental pro forma from January 1 to June 30, 2012	$ 49,027	$ 1,055

<u>Preceptor (India)</u>

In March of 2013, the Company purchased a majority (51%) of the equity interests in Preceptor Marketing Services Private Limited ("Preceptor"), a recently formed Indian corporation, from Krognos Integrated Marketing Services Private Limited ("Krognos"), and Preceptor became a new consolidated subsidiary of the Company. The Company also is providing the usual Global Contributions to Preceptor, while Krognos as the Local Investor retained the remaining minority (49%) non-controlling interest in Preceptor and is providing the usual Local Contributions. Krognos also is the Local Investor in the Company's existing subsidiary in India, SPAR Krognos Marketing Private Limited. Preceptor will enable the Company to service clients not serviced by its existing Indian subsidiary. The Company paid $21,000 for its interest in Preceptor, and Preceptor became a consolidated subsidiary of the Company on March 1, 2013.

Certain MFI Assets (USA)

In March of 2013, the Company also purchased general merchandising service and certain in-store audit service businesses from Market Force Information, Inc. ("MFI"), a leading customer intelligence solution provider. The acquired in-store audit services include the price, point of sale, out of stock, intercept and planogram audits managed by MFI's New York office. With this acquisition, the Company has entered the growing in-store audit service business and expanded its existing general merchandising service and client base domestically.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

The purchase was made pursuant to the Asset Purchase Agreement dated as of March 15, 2013 (the "Purchase Agreement") between MFI, as the seller, and SPAR Marketing Force, Inc. ("SMF"), a consolidated subsidiary of SGRP and its principal domestic operating company. The purchase was completed at the end of the day on March 15, 2013. The Purchase Price under the Purchase Agreement consisted of a cash purchase price of $1,300,000 and the assumption of certain specified liabilities (principally those arising after the closing under the assumed contracts). The Company plans to complete its purchase price valuation analysis during 2013 and record the appropriate intangible assets and or goodwill based on its analysis. In addition, SMF entered into a Consulting Services Agreement and a Transition Services Agreement with MFI, under which MFI will provide certain services, equipment and facilities for up to one year, and various assignments and other transfer documents.

The following table includes the amount of MFI's revenue and earnings included in the Company's consolidated income statement for the six months ended June 30, 2013 and a *pro forma* calculation of the amounts of MFI's revenue and earnings that would have been included in the Company's consolidated income statement for the six months ended June 30, 2013 and 2012 had the MFI acquisition date been January 1, 2013 and 2012, instead of as of March 15, 2013 (in thousands):

	Revenue		Net Income (Loss)		
Actual MFI from March 15 to June 30, 2013	$	2,719	$	389	
2013 consolidated supplemental pro forma from January 1 to June 30, 2013	$	57,037	$	(436	)
2012 consolidated supplemental pro forma from January 1 to June 30, 2012	$	50,836	$	520	

For each of the above subsidiary interest purchases, see generally Item 1 - *The Company's Domestic and International Geographic Divisions* and *Acquisition Strategies and Strategic Acquisitions*, and Item 1A - *Risks Associated with International and Domestic Joint Venture Subsidiaries*, *Risks of Having Material Local Investors in International and*

Domestic Joint Venture Subsidiaries, Risks Associated with Foreign Currency and *Risks Associated with International Business*, all in the Company's 2012 Annual Report.

12. Geographic Data

The Company operates in the same single business segment (e.g., merchandising and marketing services) in both its Domestic Merchandising Services Division and its International Merchandising Services Division. The Company uses those divisions to improve its administration and operational and strategic focuses, and it tracks and reports certain financial information separately for each of those divisions, as described in Item 1 – *Business* in the Company's 2012 Annual Report. Please also see PART I: FINANCIAL INFORMATION, Item 2 - Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources - *GENERAL - The Company's Domestic and International Geographic Divisions*, below. The Company measures the performance of its domestic and international divisions and subsidiaries using the same metrics. The primary measurement utilized by management is operating profits, historically the key indicator of long-term growth and profitability, as the Company is focused on reinvesting the operating profits of each of its international subsidiaries back into its local markets in an effort to improve market share and continued expansion efforts. Set forth below are summaries of the Company's net revenues from its United States subsidiaries (i.e., the Domestic Merchandising Services Division) and from its international (non-U.S.) subsidiaries (i.e., the International Merchandising Services Division), net revenue from certain international subsidiaries as a percent of consolidated net revenue, operating income (loss) and long lived assets by geographic area for 2013 and 2012, respectively (in thousands):

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2013	2012	**2013**	2012
Net revenues:				
United States	**$11,374**	$10,881	**$21,063**	$20,166
International	**17,322**	13,462	**33,810**	25,224
Total net revenues	**$28,696**	$24,343	**$54,873**	$45,390

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

Net revenues international:	Three Months Ended June 30, 2013	% of consolidated net revenue	2012	% of consolidated net revenue	Six Months Ended June 30, 2013	% of consolidated net revenue	2012	% of consolidated net revenue
South Africa	**$ 3,950**	**13.8 %**	$ 1,852	7.6 %	**$ 7,936**	**14.5 %**	$ 3,767	8.3 %
Mexico	**3,750**	**13.1**	3,094	12.7	**7,275**	**13.3**	6,339	14.0
Australia	**1,839**	**6.4**	1,384	5.7	**3,763**	**6.9**	2,846	6.3
Canada	**1,521**	**5.3**	1,765	7.3	**2,844**	**5.2**	3,204	7.0
India	**1,460**	**5.2**	395	1.6	**2,115**	**3.9**	936	1.9
China	**1,375**	**4.8**	677	2.8	**3,045**	**5.5**	1,541	3.6
Japan	**1,303**	**4.4**	1,597	6.6	**2,601**	**4.7**	2,869	6.3
Romania	**1,286**	**4.5**	1,763	7.2	**2,474**	**4.5**	1,969	4.3
Turkey	**838**	**2.9**	935	3.8	**1,757**	**3.2**	1,753	3.9
Total international revenues	**$ 17,322**	**60.4 %**	$ 13,462	55.3 %	**$ 33,810**	**61.7 %**	$ 25,224	55.6 %

	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Operating (loss) income:				
United States	**$(23)**	$990	**$282**	$1,321
International	**292**	(209)	**345**	(69)
Total operating income	**$269**	$781	**$627**	$1,252

June 30,	December 31,

	2013	2012
Long lived assets:		
United States	$4,515	$ 3,145
International	2,147	2,129
Total long lived assets	$6,662	$ 5,274

13. Supplemental Balance Sheet Information (in thousands)

	June 30, 2013	December 31, 2012
Accounts receivable, net, consists of the following:		
Trade	$14,146	$ 18,011
Unbilled	4,597	3,577
Non-trade	1,036	42
	19,779	21,630
Less allowance for doubtful accounts	70	216
Accounts receivable, net	$19,709	$ 21,414

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

	June 30, 2013	December 31, 2012
Property and equipment, net, consists of the following:		
Equipment	**$8,569**	$ 8,366
Furniture and fixtures	**592**	570
Leasehold improvements	**250**	250
Capitalized software development costs	**5,489**	5,044
	14,900	14,230
Less accumulated depreciation and amortization	**12,909**	12,453
Property and equipment, net	**$1,991**	$ 1,777

	June 30, 2013	December 31, 2012
Intangible assets consist of the following:		
Customer contracts and lists	**$3,069**	$ 1,804
Less accumulated amortization	**530**	336
	$2,539	$ 1,468

The Company is amortizing the customer contracts of $3.1 million on a straight line basis between 3 and 10 years. Amortization expense for the six months ended June 30, 2013 and 2012 was approximately $194,000 and $67,000, respectively. The unamortized expense for each of the following years is as follows:

Year	Amount
2013	$459
2014	525
2015	462
2016	382
2017	382
Thereafter	329
Total	$2,539

	June 30, 2013	December 31, 2012
Accrued expenses and other current liabilities consist of the following:		
Accrued salaries payable	**$804**	$ 799
Taxes payable	**1,434**	1,460
Loans from domestic and international partners	**1,180**	1,559
Accrued accounting and legal expense	**487**	358
Final payment for purchase of NMS, LLC	**-**	200
Contingent liabilities, incentive for consulting fees	**689**	689
Short term portion of capital lease obligations	**130**	