

SPAR GROUP INC  
Form 10-Q  
November 07, 2011

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 third quarterly period ended September 30, 2011.

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  
State of Incorporation

33-0684451  
IRS Employer Identification No.

560 White Plains Road, Suite 210, Tarrytown, New York 10591  
(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

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Non-Accelerated Filer   
(Do not check if a smaller reporting  
company)

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 September 30, 2011, there were 20,099,287 shares of Common Stock outstanding.

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SPAR Group, Inc.

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## PART I: FINANCIAL INFORMATION

## Item 1. Financial Statements

## SPAR Group, Inc.

Consolidated Balance Sheets  
(In thousands, except share and per share data)

|  | September 30,<br>2011<br>(unaudited) | December 31,<br>2010<br>(note) |
|--|--------------------------------------|--------------------------------|
| Assets   |                                      |                                |
| Current assets:  |                                      |                                |
| Cash and cash equivalents  | \$1,638                              | \$923                          |
| Accounts receivable, net   | 12,696                               | 13,999                         |
| Prepaid expenses and other current assets  | 772                                  | 1,283                          |
| Total current assets   | 15,106                               | 16,205                         |
| Property and equipment, net  | 1,527                                | 1,452                          |
| Goodwill   | 848                                  | 848                            |
| Intangibles  | 990                                  | 362                            |
| Other assets   | 419                                  | 226                            |
| Total assets   | \$18,890                             | \$19,093                       |
| Liabilities and equity   |                                      |                                |
| Current liabilities:   |                                      |                                |
| Accounts payable   | \$1,541                              | \$1,804                        |
| Accrued expenses and other current liabilities   | 2,498                                | 2,733                          |
| Accrued expenses due to affiliates   | 1,237                                | 1,575                          |
| Customer deposits  | 157                                  | 471                            |
| Lines of credit and other debt   | 4,155                                | 5,263                          |
| Total current liabilities  | 9,588                                | 11,846                         |
| Other long-term liabilities  | 391                                  | –                              |
| Total liabilities  | 9,979                                | 11,846                         |
| Equity:  |                                      |                                |
| SPAR Group, Inc. equity  |                                      |                                |
| Preferred stock, \$.01 par value: Authorized and available shares – 2,445,598                          |                                      |                                |
| Issued and outstanding shares – none – September 30, 2011, and<br>554,402 – December 31, 2010          | –                                    | 6                              |
| Common stock, \$.01 par value: Authorized shares – 47,000,000  |                                      |                                |
| Issued and outstanding shares – 20,099,287 – September 30, 2011, and<br>19,314,306 – December 31, 2010 | 201                                  | 193                            |
| Treasury stock   | –                                    | (1 )                           |
| Additional paid-in capital   | 13,777                               | 13,549                         |
| Accumulated other comprehensive loss   | (280 )                               | (142 )                         |
| Accumulated deficit  | (5,830 )                             | (6,808 )                       |
| Total SPAR Group, Inc. equity  | 7,868                                | 6,797                          |
| Non-controlling interest   | 1,043                                | 450                            |

|                              |          |          |
|------------------------------|----------|----------|
| Total liabilities and equity | \$18,890 | \$19,093 |
|------------------------------|----------|----------|

Note: The Balance Sheet at December 31, 2010, 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.  
Consolidated Statements of Income  
(unaudited)  
(In thousands, except per share data)

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2011                                | 2010     | 2011                               | 2010     |
| Net revenues   | \$17,564                            | \$15,674 | \$49,925                           | \$44,415 |
| Cost of revenues   | 12,515                              | 10,730   | 34,684                             | 29,990   |
| Gross profit   | 5,049                               | 4,944    | 15,241                             | 14,425   |
| Selling, general and administrative expenses                   | 4,368                               | 4,350    | 13,078                             | 12,520   |
| Depreciation and amortization                                  | 280                                 | 229      | 808                                | 725      |
| Operating income   | 401                                 | 365      | 1,355                              | 1,180    |
| Interest expense, net  | 55                                  | 36       | 160                                | 138      |
| Other (income) expense   | (30)                                | (77)     | (22)                               | 15       |
| Income before provision for income taxes                       | 376                                 | 406      | 1,217                              | 1,027    |
| Provision for income taxes                                     | 17                                  | 40       | 72                                 | 74       |
| Net income   | 359                                 | 366      | 1,145                              | 953      |
| Net (income) loss attributable to the non-controlling interest | (112)                               | (41)     | (137)                              | 20       |
| Net income attributable to SPAR Group, Inc.                    | \$247                               | \$325    | \$1,008                            | \$973    |
| Basic/diluted net income per common share:                     |                                     |          |                                    |          |
| Net income – basic/diluted                                     | \$0.01                              | \$0.02   | \$0.05                             | \$0.05   |
| Weighted average common shares – basic                         | 20,081                              | 19,203   | 19,911                             | 19,161   |
| Weighted average common shares- diluted                        | 21,536                              | 20,705   | 21,423                             | 20,392   |

See accompanying notes.

SPAR Group, Inc. and Subsidiaries  
Consolidated Statement of Equity  
(unaudited)  
(In thousands)

|   | Preferred Stock |        | Common Stock |        |                |                 | Accumulated | Other       | Comprehensive Non- | Controlling Interest | Total Equity |
|---|-----------------|--------|--------------|--------|----------------|-----------------|-------------|-------------|--------------------|----------------------|--------------|
|   | Shares          | Amount | Shares       | Amount | Treasury Stock | Paid-In Capital | Deficit     | (Loss) Gain |                    |                      |              |
| Balance at December 31, 2010  | 554             | \$ 6   | 19,314       | \$ 193 | \$ (1 )        | \$ 13,549       | \$ (6,808 ) | \$ (142 )   | \$ 450             | \$ 7,247             |              |
| Preferred stock and accrued dividends converted to common stock     | (554)           | (6 )   | 609          | 6      | —              | —               | —           | —           | —                  | —                    |              |
| Exercise of warrants  |                 |        | 75           | 1      | —              | 63              | —           | —           | —                  | 64                   |              |
| Issuance of stock options to employees & non-employees for services |                 |        | —            | —      | —              | 258             | —           | —           | —                  | 258                  |              |
| Exercise of Options   |                 |        | 101          | 1      | —              | 35              | —           | —           | —                  | 36                   |              |
| Sale of non-controlling interest of subsidiary in India             |                 |        |              |        |                | (127 )          |             |             | 217                | 90                   |              |
| Establishment of new subsidiaries with non-controlling interest     |                 |        |              |        |                |                 |             |             | 117                | 117                  |              |
| Distribution of subsidiary's equity                                 |                 |        |              |        |                |                 | (30 )       |             | 122                | 92                   |              |
| Reissued treasury stock   |                 |        |              |        | 1              | (1 )            |             |             |                    | —                    |              |
| Comprehensive income:   |                 |        |              |        |                |                 |             |             |                    |                      |              |
| Foreign currency translation gain                                   |                 |        | —            | —      | —              | —               | —           | (138 )      | —                  | (138 )               |              |
| Net Income  |                 |        |              |        |                |                 | 1,008       | —           | 137                | 1,145                |              |
|   |                 |        |              |        |                |                 | 1,008       | (138 )      | 137                | 1,007                |              |



Comprehensive  
income

Balance at

September 30,

2011                    -            \$ -            20,099    \$ 201    \$ -    \$ 13,777    \$ (5,830 )    \$ (280 )    \$ 1,043    \$ 8,911

See accompanying notes.

SPAR Group, Inc.

Consolidated Statements of Cash Flows  
(unaudited)  
(In thousands)

|  | Nine Months Ended September |          |
|--|-----------------------------|----------|
|  | 30,                         |          |
|  | 2011                        | 2010     |
| Operating activities   |                             |          |
| Net income   | \$1,145                     | \$953    |
| Adjustments to reconcile net income to net cash provided by operating activities |                             |          |
| Depreciation & Amortization  | 808                         | 725      |
| Issuance of stock options and warrants   | 258                         | 154      |
| Changes in non-controlling interest  | 124                         | 119      |
| Changes in operating assets and liabilities:                                     |                             |          |
| Accounts receivable  | 1,253                       | (2,750 ) |
| Prepaid expenses and other assets  | 318                         | 1,647    |
| Accounts Payable   | (263 )                      | (1,503 ) |
| Accrued expenses, other current liabilities and customer deposits                | (1,256 )                    | 425      |
| Net cash provided by (used in) operating activities                              | 2,387                       | (230 )   |
| Investing activities   |                             |          |
| Purchases of property and equipment and capitalized software                     | (444 )                      | (1,202 ) |
| Purchase of Mexican subsidiary   | (400 )                      | –        |
| Net cash (used in) investing activities  | (844 )                      | (1,202 ) |
| Financing activities   |                             |          |
| Net (payments) proceeds on lines of credit                                       | (552 )                      | 176      |
| Proceeds from options exercised  | 35                          | 6        |
| Proceeds from term debt  | 244                         | 500      |
| Payment on term debt   | (500 )                      | –        |
| Payments on capital lease obligations  | (75 )                       | (101 )   |
| Net cash (used in) provided by financing activities                              | (848 )                      | 581      |
| Effects of foreign exchange rate on cash   | 20                          | 49       |
| Net change in cash and cash equivalents  | 715                         | (802 )   |
| Cash and cash equivalents at beginning of period                                 | 923                         | 1,659    |
| Cash and cash equivalents at end of period                                       | \$1,638                     | \$857    |
| Supplemental disclosure of cash flows information                                |                             |          |
| Interest paid  | \$160                       | \$207    |
| Taxes paid   | \$198                       | \$162    |
| Supplemental disclosure of non-cash financing activities                         |                             |          |
| Liability related to acquisition of Mexican subsidiary                           | \$300                       | \$–      |
| Preferred stock converted to common stock at par                                 | \$6                         | \$–      |
| Acquisition of equipment through capital lease                                   | \$140                       | \$–      |

See accompanying notes.

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SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited)

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 Company's Annual Report for 2010 on Form 10-K for the year ended December 31, 2010, as filed with the Securities and Exchange Commission (the "SEC") on March 15, 2011 (the "Company's Annual Report"). 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

SPAR Group is a diversified international merchandising and marketing services company and provides a broad array of services worldwide to help companies improve their sales, operating efficiency and profits at retail locations. The Company provides its merchandising and other marketing services to manufacturers, distributors and retailers worldwide, primarily in mass merchandisers, office supply, grocery, drug store and other chains, and independent, convenience and electronics stores. The Company also provides furniture and other product assembly services in stores, homes and offices. The Company has supplied these project and product services in the United States since certain of its predecessors were formed in 1979 and internationally since the Company acquired its first international subsidiary in Japan in May of 2001. Today the Company currently operates in 9 countries that encompass approximately 46% of the total world population through operations in the United States, Canada, Japan, South Africa, India, Romania, China, Australia and Mexico.

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. The Company continues to seek to expand its merchandising, assembly and marketing services business throughout the world.

In order to cultivate foreign markets and expand the Company's merchandising and marketing services business outside of the United States, modify the necessary systems and implement its business model worldwide, and insure a consistent approach to its merchandising and marketing efforts worldwide, and even though it operates in a single business segment (merchandising and marketing services), the Company has divided its world focus into two geographic areas, the United States, which is the sales territory for its Domestic Merchandising Services Division, and international (i.e., all locations outside the United States), which are the sales territories for its International Merchandising Services Division. To that end, the Company also (1) provides and requires all of its locations to use

its Internet based operating, scheduling, tracking and reporting systems (including language translations, ongoing client and financial reports and ongoing IT support), (2) provides and requires all of its locations to comply with the Company's financial reporting and disclosure controls and procedures, (3) provides accounting and auditing support and tracks and reports certain financial and other information separately for those two divisions, and (4) has management teams in its corporate offices responsible for supporting and monitoring the management, sales, marketing and operations of each of the Company's international subsidiaries and maintaining consistency with the Company's other subsidiaries worldwide.

## 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<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|---|-------------------------------------|--------|------------------------------------|--------|
|   | 2011                                | 2010   | 2011                               | 2010   |
| Numerator:  |                                     |        |                                    |        |
| Net income  | \$247                               | \$325  | \$1,008                            | \$973  |
| Denominator:  |                                     |        |                                    |        |
| Shares used in basic net income per share calculation   | 20,081                              | 19,203 | 19,911                             | 19,161 |
| Effect of diluted securities:                           |                                     |        |                                    |        |
| Employee stock options                                  | 1,455                               | 1,502  | 1,512                              | 1,231  |
| Shares used in diluted net income per share calculation | 21,536                              | 20,705 | 21,423                             | 20,392 |
| Basic and diluted net income per common share           | \$0.01                              | \$0.02 | \$0.05                             | \$0.05 |

## 4. Lines of Credit

Domestic Credit Facility ("Sterling Credit Facility"):

SGRP and certain of its domestic direct and indirect subsidiaries, namely SPAR Marketing Force, Inc., National Assembly Services, Inc., SPAR Group International, Inc., SPAR Trademarks, Inc., SPAR Incentive Marketing, Inc., PIA Merchandising Co., Inc., and SPAR Acquisition, Inc. (each a "Subsidiary Borrower", and together with SGRP, collectively, the "Borrowers"), entered into a Revolving Loan and Security Agreement dated as of July 6, 2010 (the "Loan Agreement"), with Sterling National Bank and Cornerstone Bank as the lenders (the "Lenders"), and issued their Secured Revolving Loan Notes in the original maximum principal amounts of \$5.0 million to Sterling National Bank and \$1.5 million to Cornerstone Bank (the "Notes"), to document and govern its new credit facility with them (the "Sterling Credit Facility"). In June 2011, the Lenders agreed to: (1) reduce the personal guarantee limits as noted below, and (2) extend the maturity of the Sterling Credit Facility until July 2013.

In addition, Mr. Robert G. Brown, a Director, the Chairman and a major stockholder of SGRP, and Mr. William H. Bartels, a Director, the Vice Chairman and a major stockholder of SGRP, have provided personal guarantees of the Sterling Credit Facility totaling \$1,250,000 pursuant to their Limited Continuing Guaranty in favor of the Lenders dated as of July 6, 2010, as amended in June 2011 (the "Limited Guaranty").

Revolving Loans of up to \$6.5 million are available to the Borrowers under the new Sterling Credit Facility based upon the borrowing base formula defined in the Loan Agreement (principally 85% of "eligible" domestic accounts receivable less certain reserves). The Sterling Credit Facility is secured by substantially all of the assets of the Borrowers (other than SGRP's foreign subsidiaries, certain designated domestic subsidiaries, and their respective

equity and assets).

The basic interest rate under the Sterling Credit Facility is equal to the fluctuating Prime Rate of interest published in the Wall Street Journal from time to time plus one and one-half (1.50%) percent per annum, which automatically changes with each change in such rate.

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## SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited) (continued)

Due of the requirement to maintain a lock box arrangement with the Agent and the Lenders' ability to invoke a subjective acceleration clause at its discretion, borrowings under the Sterling Credit Facility will be classified as current.

The Sterling Credit Facility contains certain financial and other restrictive covenants and also limits certain expenditures by the Borrowers, including, but not limited to, capital expenditures and other investments. At September 30, 2011, the Company was in compliance with such covenants and does not expect to be in violation at future measurement dates. However, there can be no assurances that the Company will not be in violation of certain covenants in the future, and should the Company be in violation; there can be no assurances that the Lenders will issue waivers for any future violations.

## International Credit Facilities:

In 2008, the Australian subsidiary, SPARFACTS Australia Pty. Ltd., entered into a revolving line of credit arrangement (as amended in September 2009) with Commonwealth Bank of Australia (CBA) for \$1.5 million (Australian), or approximately \$1.5 million (based upon the exchange rate at September 30, 2011).

On October 20, 2006, SPAR Canada Company, a wholly owned subsidiary, entered into a secured credit agreement with Royal Bank of Canada providing for a Demand Operating Loan for a maximum borrowing of \$750,000 (Canadian) or approximately \$726,000 (based upon the exchange rate at September 30, 2011). The Demand Operating Loan provides for borrowing based upon a formula as defined in the agreement (principally 75% of eligible accounts receivable less certain deductions) and a minimum total debt to tangible net worth covenant. The Company was in compliance with the minimum total debt to tangible net worth covenant under this line of credit at September 30, 2011.

On March 26, 2010 the Company signed a Loan and Security Agreement and a Promissory Note with Michael Anthony Holdings, Inc. for a total of \$500,000 which was used for the acquisition of certain assets of a Canadian company that closed on April 1, 2010. The loan was payable on an interest only basis and matured on March 31, 2011 and was paid in full on that date.

On March 7, 2011, the Japanese subsidiary, SPAR FM Japan, Inc., a wholly owned subsidiary, secured a loan with Mizuho Bank in the amount of 20.0 million Japanese Yen, or approximately \$261,000. The loan is payable in monthly installments of 238,000 Yen or \$3,100 at an interest rate of 0.1% per annum with a maturity date of February 28, 2018. The outstanding balance at September 30, 2011, was approximately 18 million Yen or \$239,000 (based upon the exchange rate at September 30, 2011).

## Summary of Company Credit and Other Debt Facilities:

(in thousands)

|  | September 30,<br>2011 | Average<br>Interest Rate | December 31,<br>2010 | Average<br>Interest Rate |   |
|--|-----------------------|--------------------------|----------------------|--------------------------|---|
| Credit Facility Loan Balance:                  |                       |                          |                      |                          |   |
| USA, Sterling Credit Facility and predecessors | \$3,782               | 4.75                     | % \$3,536            | 4.87                     | % |



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|           |         |       |   |         |       |   |
|-----------|---------|-------|---|---------|-------|---|
| Australia | 131     | 10.24 | % | 548     | 10.24 | % |
| Canada    | 242     | 4.00  | % | 623     | 4.00  | % |
|           | \$4,155 |       |   | \$4,707 |       |   |

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## SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited) (continued)

|                         | September 30,<br>2011 | December 31,<br>2010 |
|-------------------------|-----------------------|----------------------|
| Unused Availability:    |                       |                      |
| USA – Sterling Facility | \$2,300               | \$1,700              |
| Australia               | 1,369                 | 952                  |
| Canada                  | 149                   | 87                   |
|                         | \$3,818               | \$2,739              |
|                         |                       |                      |
| Other Debt:             | \$239                 | \$556                |

5. Capital Lease Obligations

The Company has three outstanding capital lease obligations (in thousands):

| Start Date:   | Original Cost | Accumulated<br>Depreciation | Net Book<br>Value as of<br>September 30,<br>2011 |
|---------------|---------------|-----------------------------|--|
| July 2010     | \$215         | \$84                        | \$131  |
| November 2010 | 48            | 15                          | 33   |
| June 2011     | 140           | 11                          | 129  |
|               | \$403         | \$110                       | \$293  |

Annual future minimum lease payments required under the lease, together with the present value as of September 30, 2011, are as follows (in thousands):

| Year Ending<br>December 31,  | Amount |
|--|--------|
| 2011   | \$ 38  |
| 2012   | 154    |
| 2013   | 110    |
| 2014   | 23     |
|  | 325    |
| Less amount representing interest  | 32     |
| Present value of net minimum lease<br>payments included with other liabilities | \$ 293 |

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 Dated (as of) May 1, 2004 (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 customer or vendor of the Company other than pursuant to any Approved Activity. Approved Activities include (among other things) anything disclosed to and approved by the Board, the Governance Committee or the Audit Committee, as the case may be, as well as the ownership, board and executive positions held by certain executive officers in SMS and SMSI (as defined and described below). 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 Charter, and its Audit Committee as provided in clause I.2(1) of the Audit Charter. The Governance Committee and Audit Committee each consist solely of independent outside directors.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited) (continued)

SGRP's Audit Committee periodically reviews and has approved all of the related party relationships and transactions described above, as required by and in accordance with its Charter and the Company's Code of Ethical Conduct, NASDAQ rules and applicable law, the Audit Committee reviews each material related party transaction for its overall fairness to the Company, both initially and periodically (often annually), which review includes (without limitation) the costs and benefits to the Company, the other terms of the transactions, the affiliated relationship of the parties, and whether the overall economic and other terms are (or continue to be) no less favorable to the Company than would be the case with an unrelated provider of substantially similar services.

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 executive officers and the sole stockholders and directors of SPAR Marketing Services, Inc. ("SMS"), SPAR Management Services, Inc. ("SMSI"), and SPAR InfoTech, Inc. ("SIT").

SMS and SMSI provided approximately 99% of the Company's domestic merchandising specialists field force for both the nine months ended September 30, 2011 and 2010, and approximately 92% and 91% of the Company's domestic field management at a total cost of approximately \$16.1 million and \$14.8 million for the nine months ended September 30, 2011 and 2010, respectively. Pursuant to the terms of the Amended and Restated Field Service Agreement dated as of January 1, 2004, as amended (the "Field Services Agreement"), SMS provides merchandising services to the Company through the use of approximately 6,600 of its field force of merchandising specialists. Pursuant to the terms of the Amended and Restated Field Management Agreement dated as of January 1, 2004, SMSI provides 54 full-time national, regional and district managers to the Company. For those services, the Company has agreed to reimburse SMS and SMSI for all of their costs of providing those services and to pay SMS and SMSI each a premium equal to 4% of their respective costs (the "Plus Compensation"). The total Plus Compensation earned by SMS and SMSI for services rendered was approximately \$622,000 and \$565,000 for the nine months ended September 30, 2011 and 2010, respectively.

The Company has continued to purchase those services because it believes the terms 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 periodically engages an outside firm to conduct a survey of fees and rates charged by comparable national labor sourcing firms to serve as a comparison to the rates charged by such affiliates. The most recent such survey showed that the rates negotiated with the Affiliates are in fact slightly less than those charged by unrelated vendors providing similar services. The Company's cost of revenue would have increased by \$485,000 and \$444,000 for the nine months ended September 30, 2011 and 2010, respectively, if the Company would have instead used an unaffiliated entity to provide comparable services at the surveyed rates. All affiliate contracts are reviewed and approved by SGRP's Audit Committee, as described below.

The Company has been advised that Messrs. Brown and Bartels are not paid any salaries as officers of SMS or SMSI so there were no salary reimbursements for them included in such costs or premium. 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.

In July 2008, the Company, through SPAR Marketing Force, Inc. ("SMF"), entered into a new Master Lease Agreement with SMS, and in July and September of 2008 entered into new separate operating leases with SMS pursuant to Equipment Leasing Schedules under that Master Lease Agreement. Each operating lease had a 36 month term and representations, covenants and defaults customary for the leasing industry. The leases are for handheld computers to

be used by field merchandisers in the performance of various merchandising and marketing services in the United States and have a total monthly payment of \$11,067. These handheld computers had an original purchase price of \$401,188. The monthly payments were based upon a lease factor of 3.1%. As of September 2011, these lease agreements expired and were paid in full. In addition, SMS has granted SMF continued use of the equipment at no additional charge to insure continued compliance with the Field Services Agreement noted above. The Company estimates that the value of the handheld computers is approximately \$2,000 to \$4,000 per month.

## SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
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The following transactions occurred between the Company and the above affiliates (in thousands):

|                                       | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |          |
|---------------------------------------|-------------------------------------|---------|------------------------------------|----------|
|                                       | 2011                                | 2010    | 2011                               | 2010     |
| Services provided by affiliates:      |                                     |         |                                    |          |
| Merchandising services (SMS)          | \$4,234                             | \$4,250 | \$12,941                           | \$11,731 |
| Field management services (SMSI)      | \$1,068                             | \$1,020 | \$3,250                            | \$3,075  |
| Handheld computer leases (SMS)        | \$11                                | \$33    | \$77                               | \$99     |
| Total services provided by affiliates | \$5,313                             | \$5,303 | \$16,268                           | \$14,905 |

|  | September<br>30,<br>2011 | December<br>31,<br>2010 |
|--|--------------------------|-------------------------|
|--|--------------------------|-------------------------|

|   |         |         |
|---|---------|---------|
| Total accrued expenses<br>due to affiliates | \$1,237 | \$1,575 |
|---|---------|---------|

In July 1999, SMF, SMS and SIT entered into a 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 made or procured by any of them. In addition, SPAR Trademarks, Inc. ("STM"), SMS and SIT entered into separate 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 through SMS) for their continued use of the name "SPAR" and certain other trademarks and related rights transferred to STM, a wholly owned subsidiary of SGRP.

Through arrangements with the Company, SMS and SMSI 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 transactions between the Company and the above affiliates are paid and/or collected by the Company in the normal course of business.

In addition to the above, through the services of Affinity Insurance, Ltd. ("Affinity"), the Company purchases insurance coverage for its casualty and property insurance risk. The Company's Chairman and Vice Chairman own, through SMSI, a minority (less than 1%) equity interest in Affinity.

On December 31, 2010, there were 338,801 shares of SGRP's Series A Preferred Stock owned by a non-SGRP retirement plan whose trustee is and beneficiaries include Robert G. Brown (who is a co-founder, director, executive officer and significant shareholder of SGRP), and there were 215,601 shares of SGRP's Series A Preferred Stock owned by a non-SGRP retirement plan whose trustee is and beneficiaries include William H. Bartels (who also is a co-founder, director, executive officer and significant shareholder of SGRP), which shares collectively constituted all

of the outstanding shares of Series A Preferred Stock issued by SGRP. Those shares were originally purchased pursuant to subscription agreements on March 31, 2008, and September 24, 2008, at the closing Nasdaq bid price of SGRP's Common Stock for the preceding trading day, which was \$1.12 per share for the March purchases and \$0.86 per share for the September purchases. Each share of SGRP's Series A Preferred Stock could be converted into one share of SGRP's Common Stock (at the rate of one to one), at the option of the holder and without further consideration, and accumulated dividends at the rate of ten percent per annum. SGRP's Audit Committee and Board of Directors each reviewed and unanimously approved this transaction, including the pricing, conversion and other terms of the Preferred Stock and the affiliated relationship of the parties. The offer and sale of such Preferred Stock have not been registered under the Securities Act or other securities laws, as they were a non-public offer and sale made in reliance upon (among other things) Section 4 (2) of the Securities Act.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited) (continued)

On or before March 10, 2011, Mr. Brown and Mr. Bartels, as trustees of those plans, each had requested that their plan's preferred shares be converted into SGRP's Common Stock in accordance with its terms, and in order to facilitate conversion of those shares by payment of all accrued and unpaid dividends, on March 10, 2011, SGRP's Board of Directors (i) fixed March 10, 2011, as the applicable record date for determination of the holders of the SGRP's Series A Preferred Stock eligible to receive such dividends, (ii) declared a dividend on such SGRP's Series A Preferred Stock equal to the accrued and unpaid dividends thereon, payable in shares of SGRP's Common Stock valued at their market value (\$2.34 per share) on such record date, and (iii) authorized the issuance of the shares of SGRP's Common Stock necessary to effect such conversion (554,402 shares) and accrued dividend payment (54,584 shares) in consideration of the preferred shares surrendered and the accrued dividends thereby satisfied. As a result of such conversions and stock dividends, on March 11, 2011, Mr. Brown's plans received 372,158 shares of SGRP's Common Stock (33,357 shares of which were for accrued dividends) and Mr. Bartel's plan received 236,828 shares of SGRP's Common Stock (21,227 shares of which were for accrued dividends).

In the event of any material dispute in the business relationships between the Company and SMS, SMSI, or SIT, it is possible that Messrs. Brown or Bartels 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 authorized 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. After the Series A Preferred Stock conversion described in Note 6, above, 2,445,598 shares of SGRP Series A Preferred Stock remained 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

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 its 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 has the authority to issue other types of stock-based awards under the 2008 Plan, but (except for the restricted stock award described below) to date it has not done so.



On May 29, 2008, SGRP's stockholders approved and adopted the 2008 Plan as the successor to the Prior Plans with respect to all new options issued. The 2008 Plan provides for the granting of either incentive or nonqualified stock options to purchase SGRP Shares, restricted SGRP Shares, and restricted stock units, stock appreciation rights and other awards based on SGRP Shares ("Awards") to SGRP Directors and the Company's specified executives, employees and consultants (which are employees of certain of its affiliates), although to date SGRP has not issued any permissible form of award other than stock options. Unless terminated sooner as provided therein, the 2008 Plan will terminate on May 28, 2018, which is ten years from the 2008 Plan Effective Date, and no further Awards may be made under it. However, any existing Awards made prior to such termination will continue in accordance with their respective terms and will continue to be governed by the 2008 Plan. Stock options granted under the 2008 Plan have a maximum term of ten years, except in the case of incentive stock options granted to greater than 10% stockholders (whose terms are limited to a maximum of five years), and SGRP has generally issued options having maximum terms.

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"), which Outstanding Covered Shares for this purpose consist of the sum of (i) the SGRP Shares covered by all Awards issued under the 2008 Plan on or after May 29, 2008 ("New Awards"), plus (ii) and the SGRP Shares covered by all stock options issued at any time under the 2000 Plan or 1995 Plan to the extent they were still outstanding on May 29, 2008 ("Continuing Awards"). SGRP Shares covered by New Awards or Continuing Awards that expire, lapse, terminate, are forfeited, become void or otherwise cease to exist (other than as a result of exercise) are no longer Outstanding Covered Shares, are added back to remaining availability under the Maximum Covered Shares and thus become available for New Award grants, while those SGRP Shares covered by exercised New Awards or Continuing Awards continue to be Outstanding Covered Shares and are not added back to, and thus continue to reduce, the remaining availability under the Maximum Covered Shares under the 2008 Plan. The Outstanding Covered Shares and Maximum Covered Shares (as well as the SGRP Shares covered by a particular Award) are all subject to certain adjustments that may be made by the Compensation Committee upon the occurrence of certain changes in the Corporation's capitalization or structure as provided in the 2008 Plan. Except for the adjustments described above, an increase in the Maximum Covered Shares requires the consent of the SGRP stockholders under the terms of the 2008 Plan and Exchange Rules.

Stock options may be issued from time to time by SGRP in its discretion. At each of its regular quarterly meetings, the Compensation Committee receives, discusses and approves (as and to the extent modified by them) management's recommendations respecting the discretionary issuance of stock options to executives and employees of the Company pursuant to the 2008 Plan. The Chairman of the Board or the Compensation Committee may make those recommendations respecting Mr. Raymond, Mr. Raymond as Chief Executive Officer makes those recommendations respecting Mr. Segreto, Ms. Belzer and Ms. Franco, as well as for any new officer, and each of those executives in turn are allocated potential option shares for their departments and make recommendations respecting those under their supervision (subject to review and approval by Mr. Raymond). In recommending to the Compensation Committee the actual number of options (and options shares covered) to be granted to each individual, the person making the recommendation makes an assessment of the individual's contribution to the Company's overall performance, the individual's successful completion of a special project, and any significant increase or decrease in the participant's abilities, responsibilities and performance of his or her duties. The Compensation Committee reviews managements' recommendations at its meeting and determines whether and to what extent to approve the proposed stock option grants.

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. The Company accounts for its employee and affiliate employee stock option expense as compensation expense in the Company's 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.

At the 2009 Annual Meeting, the stockholders of SGRP approved the adoption of the proposed amendment to SGRP's 2008 Plan adding a new Section 12(a) thereto (the "Repricing Amendment"). For descriptions of the 2008 Plan, the Repricing Amendment and the reasons for such amendment, see "Proposal 3 – Approval of the Adoption of the Repricing Amendment to the 2008 Stock Compensation Plan" (pages 4 & 5) and "Stock Options and Purchase Plans" (pages 17 & 18) in SGRP's Proxy Statement for the 2009 Annual Meeting, as filed with the Securities and Exchange Commission on April 30, 2009.

The Repricing Amendment gives SGRP's Compensation Committee the full authority and complete flexibility from time to time to designate and modify (in its discretion) one or more of the outstanding awards (including their exercise and base prices and other components and terms) to (among other things) restore their intended values and incentives to their holders. However, the exercise price, base value or similar component (if equal to SGRP's full stock price at issuance) of any award cannot be lowered to an amount that is less than the Fair Market Value (as defined in the 2008 Plan) on the date of the applicable modification, and no modification can adversely affect an awardee's rights or obligations under an award without the awardee's consent. No further consent of SGRP's stockholders is required for any repricing or other modification of any award under the Repricing Amendment. The Repricing Amendment applies to all outstanding options and other awards, including those previously issued under predecessor plans.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited) (continued)

Based upon the Black-Scholes calculation, share-based compensation expense related to employee and non-employee stock option grants totaled \$270,000 and \$250,000 for the nine months ended September 30, 2011 and 2010, respectively. The unamortized expense as of September 30, 2011, was approximately \$905,000 for employee and non-employee outstanding stock option grants. The impact of the total share-based compensation expense on basic/diluted earnings per share was \$0.01 for both the nine months ended September 30, 2011 and 2010.

On March 10, 2011, SGRP's Compensation Committee authorized an award of 100,000 shares of restricted SGRP common stock as additional compensation to Gary S. Raymond, the Company's Chief Executive Officer and President. The restricted shares vest 20,000 shares a year over the next five (5) years, starting on March 10, 2012 and continuing through March 10, 2016, provided 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 these restricted shares will be amortized by the Company over the five (5) year vesting period starting April 1, 2011. The Company recorded a compensation expense of \$23,400 for the period ended September 30, 2011, for these restricted shares.

For more information respecting the Company's stock option and compensation plans, please see "Stock Compensation Plans" in SGRP's Proxy Statement for its 2011 meeting of stockholders as filed with the SEC on May 2, 2011.

9. Customer Deposits

Customer deposits at September 30, 2011, were \$157,000 (\$76,000 from domestic operations and \$81,000 from international operations) compared to \$471,000 at December 31, 2010 (\$139,000 from domestic operations and \$332,000 from international operations).

10. Commitments and Contingencies

International Commitments

Certain of the Company's international subsidiaries are profitable, while others are operating at a loss. In the event certain subsidiaries have continued losses, the Company may be required (by contract or to preserve its investment) to make additional cash infusions into those subsidiaries.

Legal Matters

Longstanding litigation with Safeway Inc. ("Safeway") concluded in August 2010. On October 24, 2001, Safeway filed a complaint against PIA Merchandising Co., Inc. ("PIA Co."), a wholly-owned subsidiary of SPAR Group, Inc. ("SGRP"), Pivotal Sales Company ("Pivotal"), a wholly-owned subsidiary of PIA Co., and SGRP in Alameda County (California) Superior Court, case no. 2001028498. Safeway's claims, as subsequently amended, alleged causes of action for breach of contract and breach of implied contract. PIA Co. and Pivotal filed cross-claims against Safeway, including causes of action for breach of contract and interference with economic relationships. The case proceeded to trial by jury. On May 26, 2006, the jury returned a verdict that awarded certain damages on different claims to PIA Co. and Pivotal and awarded certain damages to Safeway, resulting in a net award of \$1,307,700 to Pivotal. Judgment was entered in favor of Pivotal and against Safeway on August 14, 2006, for \$1,307,700. A subsequent order awarded Pivotal certain court costs totaling \$33,725.



## SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited) (continued)

Thereafter, both sides filed appeals. On May 27, 2010, the California Court of Appeal issued a decision affirming the judgment in full. All appellate proceedings concluded on July 28, 2010. On August 2, 2010, Safeway tendered, and the Company accepted, payment of \$1,888,000 in full payment of the judgment.

In addition to the above, the Company is a party to various other legal actions and administrative proceedings arising in the normal course of business. In the opinion of the Company's management, disposition of these other matters are not anticipated to have a material adverse effect on the Company or its estimated or desired assets, business, capital, cash flow, credit, expenses, financial condition, income, liabilities, liquidity, locations, marketing, operations, prospects, sales, strategies, taxation or other achievement, results or condition.

## 11. Acquisition and Purchase of Interest in Subsidiaries

In March 2010, the Company established a new Canadian subsidiary, SPAR Wings & Ink Company ("SWI") specifically to expand its merchandising and marketing services throughout Canada. On April 1, 2010, with the approval of SGRP's directors, SWI acquired substantially all of the business, customer contracts, receivables, work-in progress, other assets and certain liabilities of 2078281 Ontario Limited, an Ontario merchandising and marketing company doing business as Wings & Ink (the "Seller"). The Company, at closing, also hired substantially all of the Seller's employees including offering consulting contracts to the principals of the Seller.

In return for the purchase of such assets and assumed liabilities, at closing SWI compensated the Seller through 1) a cash payment of \$500,000 Canadian dollars ("CAD"), 2) issued a \$75,000 CAD interest bearing promissory note payable over an 18 month period and 3) placed \$50,000 in escrow for a 12 month period and 4) assumed \$446,000 CAD of liabilities.

The Company has completed its valuation of the fair value and allocation for the assets acquired and liabilities assumed and has recorded the following (in US dollars):

|                     |             |
|---------------------|-------------|
| Accounts Receivable | \$644,000   |
| Equipment           | 2,000       |
| Customer contracts  | 426,000     |
|                     | \$1,072,000 |

The Company is amortizing the customer contracts of \$426,000 on a straight line basis over 5 years. The net book value at September 30, 2011, and December 31, 2010 was approximately \$294,000 and \$362,000, respectively. Amortization expense for the nine months ending September 30, 2011, was approximately \$68,000.

SWI also agreed to pay an earn out to the principals of the Seller based on SWI achieving certain revenue and gross profit margin levels of the acquired business for each of the next two 12 month periods. The earn out is based on revenue and gross profit margins exceeding certain agreed upon base levels, if achieved, the principles will be paid one third of the excess gross profit dollars in each of the two 12 month periods. The Company has not recorded a contingent liability as it is unlikely these revenue and gross margin targets will be met.

In September 2010, the Company purchased the remaining 49% ownership in its India subsidiary at a cost of \$90,000 and in July 2011 the Company then entered into an agreement with KROGNOS Integrated Marketing Services Private Limited, to sell 49% ownership in the India subsidiary at a price of \$90,000.

In August 2011, the Company expanded its operations in North America by entering into an agreement with Grupo TODOPROMO to create a new subsidiary in Mexico. The new subsidiary is called SPAR TODOPROMO, SAPI, de CV., began operations in September 2011 and is owned 51% by SPAR and 49% by Grupo TODOPROMO (Grupo). The Company's total investment in Mexico is \$702,000 which consists of \$2,000 in capital and \$700,000 paid to Grupo for intangible assets. \$400,000 was paid in September 2011 and the balance is payable in 2012. The company has recorded the \$700,000 as an intangible asset. The allocation of the intangible asset between identifiable intangibles and goodwill is expected to be completed by December 31, 2011.

## SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited) (continued)

In August 2011, the Company entered into an agreement with two companies in Turkey (NDS TANITIM DANIŞMANLIK HİZMETLERİ and GIDA TEKSTİL TURİZM PAZARLAMA TİCARET LİMİTED ŞİRKETİ) to reestablish operations in this market. The agreement established a new subsidiary, SPAR NDS, owned 51% by the Company and 49% by the Turkish companies noted above. The new subsidiary is scheduled to start operations in November 2011. The Company's total investment in Turkey is approximately \$86,000

In July 2011, the Company's subsidiary in China, SPAR (Shanghai) Marketing Management Company Ltd ("SPAR Shanghai") entered into an agreement with Beijing DSI Management Consulting Company Ltd. ("DSI"), creating a new subsidiary in order to expand the Company's operations throughout the People's Republic of China. The new subsidiary is called SPAR DSI Human Resource Company ("SPAR DSI"), is owned 51% by SPAR Shanghai and 49% by DSI and is expected to be operational in November 2011.

## 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 the same metrics to measure the performance of both its domestic and international divisions. 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 (in thousands) 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 2011 and 2010, respectively:

|                                      | Three Months Ended<br>September 30,    |  | Nine Months Ended<br>September 30,     |  |
|--------------------------------------|--|--|--|--|
|                                      | 2011                                   | 2010                                   | 2011                                   | 2010                                   |
| Net revenues:                        |  |  |  |  |
| United States                        | \$8,734                                | \$9,044                                | \$27,621                               | \$26,503                               |
| International                        | 8,830                                  | 6,630                                  | 22,304                                 | 17,912                                 |
| Total net revenues                   | \$17,564                               | \$15,674                               | \$49,925                               | \$44,415                               |
|                                      | Three Months Ended September 30,       |  | Nine Months Ended September 30,        |  |
|                                      | 2011                                   | 2010                                   | 2011                                   | 2010                                   |
|                                      | % of<br>consolidated<br>net<br>revenue | % of<br>consolidated<br>net<br>revenue | % of<br>consolidated<br>net<br>revenue | % of<br>consolidated<br>net<br>revenue |
| International net<br>revenue detail: |  |  |  |  |
| Australia                            | \$2,307                                | 13.1 %                                 | \$1,788                                | 11.4 %                                 |
| Canada                               | 1,509                                  | 8.6                                    | 2,059                                  | 13.1                                   |
| South Africa                         | 1,325                                  | 7.5                                    | 612                                    | 3.9                                    |
| Japan                                | 1,185                                  | 6.8                                    | 1,143                                  | 7.3                                    |
| All Others                           | 2,504                                  | 14.3                                   | 1,028                                  | 6.6                                    |
|                                      | \$8,830                                | 50.3 %                                 | \$6,630                                | 42.3 %                                 |
|                                      |  |  | \$22,304                               | 44.7 %                                 |
|                                      |  |  | \$17,912                               | 40.3 %                                 |



Total international  
revenue

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## SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited) (continued)

|                          | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |                      |
|--------------------------|-------------------------------------|-------|------------------------------------|----------------------|
|                          | 2011                                | 2010  | 2011                               | 2010                 |
| Operating income (loss): |                                     |       |                                    |                      |
| United States            | \$341                               | \$515 | \$1,558                            | \$1,640              |
| International            | 60                                  | (150) | (203)                              | (460)                |
| Total operating income   | \$401                               | \$365 | \$1,355                            | \$1,180              |
|                          |                                     |       | September<br>30, 2011              | December 31,<br>2010 |
| Long lived assets:       |                                     |       |                                    |                      |
| United States            |                                     |       | \$2,235                            | \$2,231              |
| International            |                                     |       | 1,549                              | 657                  |
| Total long lived assets  |                                     |       | \$3,784                            | \$2,888              |

## 13. Supplemental Balance Sheet Information (in thousands)

|  | September<br>30, 2011 | December 31,<br>2010 |
|--|-----------------------|----------------------|
| Accounts receivable, net, consists of the following:                     |                       |                      |
| Trade  | \$9,926               | \$9,846              |
| Unbilled   | 2,548                 | 3,914                |
| Non-trade  | 323                   | 382                  |
|  | 12,797                | 14,142               |
| Less allowance for doubtful accounts                                     | 101                   | 143                  |
| Accounts receivable, net   | \$12,696              | \$13,999             |
|  | September 30,<br>2011 | December 31,<br>2010 |
| Property and equipment, net, consists of the following:                  |                       |                      |
| Equipment  | \$7,819               | \$7,893              |
| Furniture and fixtures   | 530                   | 541                  |
| Leasehold improvements   | 250                   | 250                  |
| Capitalized software development costs                                   | 4,099                 | 3,518                |
|  | 12,698                | 12,202               |
| Less accumulated depreciation and amortization                           | 11,171                | 10,750               |
| Property and equipment, net  | \$1,527               | \$1,452              |
|  | September 30,<br>2011 | December 31,<br>2010 |
| Accrued expenses and other current liabilities consist of the following: |                       |                      |
| Accrued salaries payable   | \$966                 | \$708                |
| Accrued accounting and legal expense                                     | 209                   | 266                  |
| Other  | 1,323                 | 1,759                |

|  |         |         |
|--|---------|---------|
| Accrued expenses and other current liabilities | \$2,498 | \$2,733 |
|--|---------|---------|

## SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited) (continued)

## 14. Foreign Currency Rate Fluctuations

The Company has foreign currency exposure with its international subsidiaries. In both 2011 and 2010, these exposures are primarily concentrated in the Australian Dollar, Canadian Dollar and Japanese Yen. International revenues for the nine months ended September 30, 2011 and 2010 were \$22.3 million and \$17.9 million, respectively. The international division reported net losses of approximately \$332,000 and \$558,000 for the nine months ended September 30, 2011 and 2010, respectively.

In those countries where the Company had risk for foreign currency exposure, the total assets were \$6.9 million and total liabilities were \$4.8 million based on exchange rates at September 30, 2011.

## 15. Interest Rate Fluctuations

The Company is exposed to market risk related to the variable interest rate on its lines of credit, both in its United States subsidiaries (i.e., the Domestic Merchandising Services Division) and in its International (non-U.S.) subsidiaries (i.e., the International Merchandising Services Division). At September 30, 2011, the Company's outstanding lines of credit and other debt totaled approximately \$4.4 million, as noted in the table below (in thousands):

| Location      | Variable<br>Interest Rate<br>(1) | US Dollars (2) |
|---------------|----------------------------------|----------------|
| United States | 4.75%                            | \$3,782        |
|               | 0.1%                             |                |
| International | -10.24%                          | 612            |
|               |                                  | \$4,394        |

(1) Based on interest rate at September 30, 2011.

(2) Based on exchange rate at September 30, 2011.

Based on the 2011 average outstanding borrowings under variable-rate debt, a one-percentage point increase in interest rates would negatively impact pre-tax earnings and cash flows for the nine months ended September 30, 2011 by approximately \$23,000.

## 16. Recently Issued Accounting Standards

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income." This ASU intends to enhance comparability and transparency of other comprehensive income components. The guidance provides an option to present total comprehensive income, the components of net income and the components of other comprehensive income in a single continuous statement or two separate but consecutive statements. This ASU eliminates the option to present other comprehensive income components as part of the statement of changes in shareowners' equity. The provisions of this ASU will be applied retrospectively for interim and annual periods beginning after December 15, 2011. Early application is permitted. We are currently evaluating the impact of this new ASU.

In September 2011, the FASB issued ASU No. 2011-07, "Goodwill and Other Intangible Assets". This ASU is intended to simplify goodwill impairment testing by adding a qualitative review step to assess whether the required quantitative

impairment analysis that exists today is necessary. The amended guidance permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. The amended guidance is effective beginning in 2012, however, with earlier adoption permitted. The Company intends to apply the updated guidance to its 2012 annual impairment test. The adoption of this update is not expected to have a significant impact on the Company's consolidated financial statements.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements  
(unaudited) (continued)

17. Taxes

In July 2006, the FASB issued an interpretation, Accounting for Uncertainty in Income Taxes, now codified as ASC Topic 740, which detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements. Tax positions must meet a more-likely-than-not recognition threshold and requires that interest and penalties that the tax law requires to be paid on the underpayment of taxes should be accrued on the difference between the amount claimed or expected to be claimed on the return and the tax benefit recognized in the financial statements. The Company's policy is to record this interest and penalties as additional tax expense. The Company's tax reserves at September 30, 2011, and December 31, 2010 totaled \$43,000, for potential domestic state tax and federal tax liabilities.

SPAR and its subsidiaries file numerous consolidated, combined and separate company income tax returns in the U.S. Federal jurisdiction and in many U.S. state and foreign jurisdictions. With few exceptions, SPAR is subject to U.S. Federal, state and local income tax examinations for the years 2005 through the present. However, tax authorities have the ability to review years prior to the position taken by the Company to the extent that SPAR utilized tax attributes carried forward from those prior years.

18. Reclassifications

Certain reclassifications have been made to the 2010 financial statements to conform to the 2011 presentation.

SPAR Group, Inc. and Subsidiaries

Item 2. Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources

Forward-Looking Statements

Statements contained in this Quarterly Report on Form 10-Q for the nine months ended September 30, 2011 (this "Quarterly Report"), of SPAR Group, Inc. ("SGRP", and together with its subsidiaries, the "SPAR Group" or the "Company"), include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act", and together with the Securities Act, the "Securities Laws"), including, in particular and without limitation, the discussions respecting net revenues from significant clients, significant chain work and international joint ventures, federal taxes and net operating loss carry forwards, commencement of operations and future funding of international joint ventures, credit facilities and covenant compliance, cost savings initiatives, liquidity and sources of cash availability in this "Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources". Such forward looking statements also are included in SGRP's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, as filed with the Securities and Exchange Commission (the "SEC") on March 15, 2011 (its "Annual Report"), including (without limitation) the statements contained in the discussions under the headings "Business", "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations". You can identify forward-looking statements in such information by the Company's use of terms such as "may", "will", "expect", "intend", "believe", "estimate", "anticipate", "continue" or similar words or variations or negatives of those words. You should carefully consider all such information and the other risks and cautions noted in this Quarterly Report, the Company's Annual Report and the Company's other filings under applicable Securities Laws (including this Quarterly Report and the Company's Annual Report, each a "SEC Report") that could cause the Company's actual assets, business, capital, cash flow, credit, expenses, financial condition, income, liabilities, liquidity, locations, marketing, operations, prospects, sales, strategies, taxation or other achievement, results, risks or condition to differ materially from those anticipated by the Company and described in the information in the Company's forward-looking statements, whether express or implied, as the Company's anticipations are based upon the Company's plans, intentions and best estimates and (although the Company believe them to be reasonable) involve known and unknown risks, uncertainties and other factors that could cause them to fail to occur or be realized or to be materially and adversely different from those the Company anticipated.

Although the Company believes that its plans, intentions and estimates reflected or implied in such forward-looking statements are reasonable, the Company cannot assure you that such plans, intentions or estimates will be achieved in whole or in part, that the Company has identified all potential risks, or that the Company can successfully avoid or mitigate such risks in whole or in part. You should carefully review the risk factors described in this Quarterly Report and the Company's Annual Report (See Item 1A – Risk Factors) and any other cautionary statements contained or incorporated by reference in this Quarterly Report, the Company's Annual Report or other SEC Report. All forward-looking and other statements attributable to the Company or persons acting on its behalf are expressly subject to and qualified by all such risk factors and other cautionary statements.

You should not place undue reliance on the Company's forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond its control. The Company's forward-looking statements are based on the information currently available to it and speak only as of September 30, 2011 (in the case of this Quarterly Report), December 31, 2010 (in the case of the Company's Annual Report) or other referenced date or, in the case of forward-looking statements contained in or incorporated by reference from another SEC Report, as of the date of or other date referenced in the SEC Report that

includes such statement. New risks and uncertainties arise from time to time, and it is impossible for the Company to predict these matters or how they may arise or affect the Company. Over time, the Company's actual assets, business, capital, cash flow, credit, expenses, financial condition, income, liabilities, liquidity, locations, marketing, operations, prospects, sales, strategies, taxation or other achievements, results, risks or condition will likely differ from those expressed or implied by the Company's forward-looking statements, and such difference could be significant and materially adverse to the Company and the value of your investment in the Company's Common Stock.



SPAR Group, Inc. and Subsidiaries

The Company does not intend or promise, and the Company expressly disclaims any obligation, to publicly update or revise any forward-looking statements, risk factors or other cautionary statements (in whole or in part), whether as a result of new information, future events or recognition or otherwise, except as and to the extent required by applicable law.

GENERAL

SPAR Group, Inc., (“SGRP”), and its subsidiaries (together with SGRP, the “SPAR Group” or the “Company”), is a diversified international merchandising and marketing services company and provides a broad array of services worldwide to help companies improve their sales, operating efficiency and profits at retail locations. The Company provides its merchandising and other marketing services to manufacturers, distributors and retailers worldwide, primarily in mass merchandisers, office supply, grocery, drug store and other chains, and independent, convenience and electronics stores. The Company also provides furniture and other product assembly services in stores, homes and offices. Today the Company currently operates in 9 countries that encompass approximately 46% of the total world population through operations in the United States, Canada, Japan, South Africa, India, Romania, China, Australia and Mexico.

An Overview of the Merchandising and Marketing Services Industry

According to industry estimates over two billion dollars is spent annually in the United States alone on retail merchandising and marketing services. The merchandising and marketing services industry includes manufacturers, retailers, food brokers and professional service merchandising companies. 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. The Company believes that merchandising and marketing services add value to retailers, manufacturers and other businesses and enhance sales by making a product more visible and more available to consumers.

Historically, retailers staffed their stores as needed to provide these services to ensure, that manufacturers’ inventory levels, the advantageous display of new items on shelves, and the maintenance of shelf schematics and product placement were properly merchandised. However retailers, in an effort to improve their margins, decreased their own store personnel and increased their reliance on manufacturers to perform such services. Initially, manufacturers attempted to satisfy the need for merchandising and marketing services in retail stores by utilizing their own sales representatives. Additionally, retailers also used their own employees to merchandise their stores to satisfy their own merchandising needs. However, both the manufacturers and the retailers discovered that using their own sales representatives and employees for this purpose was expensive and inefficient.

Manufacturers and retailers have been, and SPAR Group believes they will continue outsourcing their merchandising and marketing service needs to third parties capable of operating at a lower cost by (among other things) serving multiple manufacturers simultaneously. The Company also believes that it is well positioned, as a domestic and international merchandising and marketing services company, to more effectively provide these services to retailers,

manufacturers and other businesses around the world.

Another significant trend impacting the merchandising and marketing services business is the tendency of consumers to make product purchase decisions once inside the store. Accordingly, merchandising and marketing services and in-store product promotions have proliferated and diversified. Retailers are continually re-merchandising and re-modeling entire stores in an effort to respond to new product developments and changes in consumer preferences. We estimate that these activities have increased in frequency over the last five years. Both retailers and manufacturers are seeking third parties to help them meet the increased demand for these labor-intensive services.

SPAR Group, Inc. and Subsidiaries

In addition, the consolidation of many retailers has created opportunities for third party merchandisers when an acquired retailer's stores are converted to the look and format of the acquiring retailer. In many cases, stores are completely remodeled and re-merchandised after a consolidation.

SPAR Group believes the current trend in business toward globalization fits well with its expansion model. As companies expand into foreign markets they will need assistance in merchandising or marketing their products. As evidenced in the United States, retailer and manufacturer sponsored merchandising and marketing programs are both expensive and inefficient. The Company also believes that the difficulties encountered by these programs are only exacerbated by the logistics of operating in foreign markets. This environment has created an opportunity for the Company to exploit its internet, hand-held and smart phone-based technology and business model worldwide.

The Company's Domestic and International Geographic Divisions:

In order to cultivate foreign markets and expand the Company's merchandising and marketing services business outside of the United States, modify the necessary systems and implement its business model worldwide, and insure a consistent approach to its merchandising and marketing efforts worldwide, and even though it operates in a single business segment (merchandising and marketing services), the Company has divided its world focus into two geographic areas, the United States, which is the sales territory for its Domestic Merchandising Services Division, and international (i.e., all locations outside the United States), which are the sales territories for its International Merchandising Services Division. To that end, the Company also (1) provides and requires all of its locations to use its Internet based operating, scheduling, tracking and reporting systems (including language translations, ongoing client and financial reports and ongoing IT support), (2) provides and requires all of its locations to comply with the Company's financial reporting and disclosure controls and procedures, (3) provides accounting and auditing support and tracks and reports certain financial and other information separately for those two divisions, and (4) has management teams in its corporate offices responsible for supporting and monitoring the management, sales, marketing and operations of each of the Company's international subsidiaries and maintaining consistency with the Company's other subsidiaries worldwide.

Each of these divisions provides merchandising and other marketing services primarily on behalf of consumer product manufacturers and retailers at mass merchandisers, drug store chains, convenience and grocery stores in their respective territories. SPAR Group Inc.'s clients include the makers and distributors of home entertainment, general merchandise, health and beauty care, consumer goods and food products in their respective territories.

SPAR Group has provided merchandising and other marketing services in the United States since the formation of its predecessor in 1979 and outside the United States since it acquired its first international subsidiary in Japan in May of 2001. Today the Company currently conducts its business through its domestic and international divisions in 9 territories around the world (listed in the table below) that encompass approximately 46% of the total world population.

## SPAR Group, Inc. and Subsidiaries

The Company's international business in each territory outside the United States is conducted through a foreign subsidiary incorporated in its primary territory. The primary territory (together with each additional territory in which it conducts its business), establishment date (which may include predecessors), the percentage of the Company's equity ownership, and the principal office location for its US (domestic) subsidiaries and each of its foreign (international) subsidiaries is as follows:

| Primary Territory<br>(+ additional Territory) | Date<br>Established | SGRP<br>Percentage<br>Ownership | Principal Office<br>Location                        |
|---|---------------------|---------------------------------|---|
| United States of America                      | 1979                | 100%                            | Tarrytown, New York,<br>United States of<br>America |
| Japan   | May 2001            | 100%                            | Osaka, Japan  |
| Canada  | June 2003           | 100%                            | Toronto, Canada                                     |
| Turkey  | July 2003           | 51%*                            | Istanbul, Turkey                                    |
| South Africa                                  | April 2004          | 51%                             | Durban, South Africa                                |
| India   | April 2004          | 51%**                           | New Delhi, India                                    |
| Lithuania                                     | September 2005      | 51%***                          |   |
| Australia                                     | April 2006          | 51%                             | Melbourne, Australia                                |
| Romania                                       | July 2009           | 51%****                         | Bucharest, Romania                                  |
| China   | March 2010          | 51%*****                        | Shanghai, China                                     |
| Mexico  | August 2011         | 51%                             | Mexico City, Mexico                                 |
| Turkey  | August 2011         | 51%*****                        | Istanbul, Turkey                                    |

\* In August 2011, the Company sold its 51% ownership to its current joint venture partner.

\*\* In June 2011, the Company sold 49% of its interest to KROGNOS Integrated Marketing Services Private Limited.

\*\*\* The Company closed this subsidiary's operations in Fourth Quarter 2010.

\*\*\*\* Currently the Company owns two subsidiaries in Romania. One Subsidiary is 100% owned and the second subsidiary, acquired in July 2009, is 51% owned.

\*\*\*\*\* Currently the Company owns two subsidiaries in China. One Subsidiary is 100% owned and the second subsidiary, acquired in March 2010 and operational in August 2010, is 51% owned.

\*\*\*\*\* The Turkey subsidiary will be operational in November 2011.

One key to the Company's international expansion strategy is its internally developed capability to translate all of its current and future proprietary Internet-based logistical, communications, scheduling, tracking and reporting software applications into any language for any market in which it operates or would like to enter. Through the Company's IT operations currently located in the facilities in Auburn Hills, Michigan, it provides worldwide access to the Company's proprietary logistical, communications, scheduling, tracking and reporting software to its entire operations worldwide on a 24/7/365 basis.

Another key to the Company's international strategy is its policy of seeking a material investor in a new subsidiary in an international location who is an experienced person or company in the local country who is not otherwise affiliated with the Company (each a "Local Investor"). The Company generally seeks to own at least 51% of a foreign subsidiary. As of the date of this Quarterly Report, the Company owns 100% of the equity of its international subsidiaries in Canada and Japan, and one of its two international subsidiaries in each of China and Romania. A Local Investor provides equity, credit support and certain services to each international subsidiary not wholly owned

by the Company, as well as the useful local attention, perspective and relationships of an equity owner with a strong financial stake in such subsidiary's success. The Company provides executive management and support to each foreign subsidiary as well its operational backbone (and the Company's procedures and controls) through its proprietary Internet-based logistical, communications, scheduling, tracking, reporting and accounting programs. (See Item 1A in SGRP's Annual Report, Risks of Having Material Local Investors in International Subsidiaries.)

SPAR Group, Inc. and Subsidiaries

The Company operates in the same single business segment (e.g., merchandising and marketing services) in both its domestic and international divisions, and the Company tracks and reports certain financial information separately for each of those divisions, as described above. 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 profit level, 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 its market share and continued expansion efforts. Certain financial information regarding each of the Company's two geographic divisions, which includes their respective net revenues and operating income (loss) for each of the nine months ended September 30, 2011, and September 30, 2010, and long-lived assets at September 30, 2011, and September 30, 2010, are provided in Note 12.

Critical Accounting Policies

There were no material changes during the nine months ended September 30, 2011, to the Company's critical accounting policies as reported in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, as filed with the SEC on March 15, 2011.

## SPAR Group, Inc. and Subsidiaries

## Results of Operations

Three months ended September 30, 2011, compared to three months ended September 30, 2010

The following table sets forth selected financial data and data as a percentage of net revenues for the periods indicated (in thousands, except percent data).

|   | Three Months Ended September 30, |       | 2011       |       | 2010 |   |
|---|----------------------------------|-------|------------|-------|------|---|
|   | \$                               | %     | \$         | %     | \$   | % |
| Net revenues  | \$17,564                         | 100.0 | % \$15,674 | 100.0 | %    |   |
| Cost of revenues                                      | 12,515                           | 71.3  | 10,730     | 68.5  |      |   |
| Selling, general & administrative expense             | 4,368                            | 24.9  | 4,350      | 27.8  |      |   |
| Depreciation and amortization                         | 280                              | 1.6   | 229        | 1.5   |      |   |
| Interest expense, net                                 | 55                               | 0.3   | 36         | 0.2   |      |   |
| Other income  | (30)                             | (0.2) | (77)       | (0.6) |      |   |
| Income before income taxes                            | 376                              | 2.1   | 406        | 2.6   |      |   |
| Provision for income taxes                            | 17                               | 0.1   | 40         | 0.3   |      |   |
| Net income before non-controlling interest            | 359                              | 2.0   | 366        | 2.3   |      |   |
| Net (income) attributable to non-controlling interest | (112)                            | (0.6) | (41)       | (0.3) |      |   |
| Net income attributable to Spar Group, Inc.           | \$247                            | 1.4   | % \$325    | 2.0   | %    |   |

## Net Revenues

Net revenues for the three months ended September 30, 2011, were \$17.6 million, compared to \$15.7 million for the three months ended September 30, 2010, an increase of \$1.9 million or 12%.

Domestic net revenues totaled \$8.8 million in the three months ended September 30, 2011, compared to \$9.1 million for the same period in 2010. The domestic net revenue decrease of \$310,000 or 3.4% was mainly attributable to extraordinary project revenue realized in the third quarter of 2010, partially offset by the growth from the Company's syndicated services in 2011.

International net revenues totaled \$8.8 million for the three months ended September 30, 2011, compared to \$6.6 million for the same period in 2010, an increase of \$2.2 million or 33%. The increase in third quarter net revenues was primarily due to additional revenue from the new subsidiary in Mexico of \$978,000, an increase in South Africa of \$713,000 resulting from a new client in the general merchandising category, increase in Australia of \$519,000 due to a stronger performance in their entertainment category, and increase in China \$519,000 resulting from increased project work in the beverage category, partially offset by a decrease in Canada due to extraordinary project work in the third quarter of 2010.

## Cost of Revenues

The Company's cost of revenues consists of its in-store labor and field management wages, related benefits, travel and other direct labor-related expenses and was 71.3% of its net revenues for the three months ended September 30, 2011, compared to 68.5% of its net revenues for the three months ended September 30, 2010.

Domestic cost of revenues was 69.5% and 66.4% of net revenues for the three months ended September 30, 2011 and 2010, respectively. The cost of revenue percentage increase of 3.1% was due primarily to an unfavorable mix within both syndicated and project work as compared to prior year levels. Approximately 89% of the Company's domestic cost of revenues for both the three months ended September 30, 2011 and 2010 resulted from in-store merchandiser specialist and field management services purchased from certain of the Company's affiliates, SPAR Marketing Services, Inc. ("SMS"), and SPAR Management Services, Inc. ("SMSI"), (See - Note 6 - Related-Party Transactions).



SPAR Group, Inc. and Subsidiaries

Internationally, cost of revenues increased to 73% of net revenues for the three months ended September 30, 2011, compared to 71.2% of net revenues for the three months ended September 30, 2010. The cost of revenue percentage increase of 1.8% was primarily due to higher cost margins in our Japan, Australia and South Africa markets, partially offset by lower cost margins in Canada.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of the Company include its corporate overhead, project management, information technology, executive compensation, human resources, legal and accounting expenses. Selling, general and administrative expenses were approximately \$4.4 million for both the three months ended September 30, 2011 and 2010. Compared to last year, domestic selling, general and administrative expenses declined approximately \$200,000. This decline was directly offset by additional expenses related to the new subsidiary in Mexico and increased expenses in Australia and Japan.

Depreciation and Amortization

Depreciation and amortization expenses totaled \$280,000 for the three months ended September 30, 2011, compared to \$229,000 for the same period in 2010. The increase in depreciation expense was primarily due to higher capital expenditures for software development.

Interest Expense, net

The Company's net interest expense was \$55,000 and \$36,000 for the three months ended September 30, 2011 and 2010, respectively. The increase in net interest expense was a direct result of recognizing interest income on the Safeway settlement in July 2010 and higher debt levels in 2011 compared to 2010.

Other Income

The other income of \$30,000 for the three months ended September 30, 2011, is primarily due to the sale of the subsidiary in Turkey. The other income of \$77,000 for the three months ended September 30, 2010 is primarily due to income from a favorable legal settlement.

Income Taxes

The income tax provision for the three months ended September 30, 2011 and 2010 was \$17,000 and \$40,000, respectively. The tax provision resulted primarily from domestic state taxes and for tax provisions related to certain international profits. The Company recognizes minimum federal tax provisions as the Company continues to anticipate utilizing operating loss carry forwards in 2011.

Non-controlling Interest

Net operating profits from the non-controlling interest, from the Company's 51% owned subsidiaries, resulted in a reduction of net income of \$112,000 and \$41,000 for the three months ended September 30, 2011, and September 30, 2010, respectively.

Net Income

The Company reported a net income of \$247,000, or \$0.01 per diluted share, for the three months ended September 30, 2011, compared to a net income of \$325,000, or \$0.02 per diluted share, for the corresponding period last year.

## SPAR Group, Inc. and Subsidiaries

## Results of Operations

Nine months ended September 30, 2011, compared to nine months ended September 30, 2010

The following table sets forth selected financial data and data as a percentage of net revenues for the periods indicated (in thousands, except percent data).

|  | Nine Months Ended September 30,<br>2011 |       | 2010       |       |   |
|--|---|-------|------------|-------|---|
|  | \$                                      | %     | \$         | %     |   |
| Net revenues   | \$49,925                                | 100.0 | % \$44,415 | 100.0 | % |
| Cost of revenues   | 34,684                                  | 69.5  | 29,990     | 67.5  |   |
| Selling, general & administrative expense                  | 13,078                                  | 26.2  | 12,520     | 28.2  |   |
| Depreciation and amortization                              | 808                                     | 1.6   | 725        | 1.6   |   |
| Interest expense, net                                      | 160                                     | 0.3   | 138        | 0.3   |   |
| Other (income) expense                                     | (22)                                    | –     | 15         | 0.1   |   |
| Income before income taxes                                 | 1,217                                   | 2.4   | 1,027      | 2.3   |   |
| Provision for income taxes                                 | 72                                      | 0.1   | 74         | 0.2   |   |
| Net income before non-controlling interest                 | 1,145                                   | 2.3   | 953        | 2.1   |   |
| Net (income) loss attributable to non-controlling interest | (137)                                   | (0.3) | 20         | 0.1   |   |
| Net income attributable to Spar Group, Inc.                | \$1,008                                 | 2.0   | % \$973    | 2.2   | % |

## Net Revenues

Net revenues for the nine months ended September 30, 2011, were \$49.9 million, compared to \$44.4 million for the nine months ended September 30, 2010, an increase of \$5.5 million or 12%.

Domestic net revenues totaled \$27.6 million in the nine months ended September 30, 2011, compared to \$26.5 million for the same period in 2010. Domestic net revenues increased by \$1.1 million or 4% primarily attributable to continued growth from the Company's syndicated services as well as growth in the assembly business.

International net revenues totaled \$22.3 million for the nine months ended September 30, 2011, compared to \$17.9 million for the same period in 2010, an increase of \$4.4 million or 24.5%. The increase in 2011 international net revenues was primarily due to increases in China of \$1.9 million resulting from increased project work in the beverage category, in Australia of \$1.3 million due to a stronger performance in their entertainment category, and in South Africa of \$1.0 million primarily attributed to a new client in the general merchandise category, and \$978,000 for the addition of Mexico in September 2011, partially offset by a decrease in India due to the loss of a key client in the first quarter of 2010.

## Cost of Revenues

The Company's cost of revenues consists of its in-store labor and field management wages, related benefits, travel and other direct labor-related expenses and was 69.5% of net revenues for the nine months ended September 30, 2011,

compared to 67.5% of net revenues for the nine months ended September 30, 2010.

Domestic cost of revenues was 67.9% of net revenues for the nine months ended September 30, 2011, and 65.3% of net revenues for the nine months ended September 30, 2010. The increase in cost of revenues as a percentage of net revenues was 2.6% due primarily to an unfavorable mix within both syndicated and project work compared to the prior year. Approximately 88% and 87% of the Company's domestic cost of revenues in the nine months ended September 30, 2011 and 2010, respectively, resulted from in-store merchandiser specialist and field management services purchased from certain of the Company's affiliates, SPAR Marketing Services, Inc. ("SMS"), and SPAR Management Services, Inc. ("SMSI"), (See - Note 6 - Related-Party Transactions).

SPAR Group, Inc. and Subsidiaries

Internationally, cost of revenue as a percent of net revenue increased slightly to 71.4% of net revenues for the nine months ended September 30, 2011, compared to 70.9% of net revenues for the nine months ended September 30, 2010. The increase was due to higher cost margin business in the China and Japan markets, as well as the new subsidiary in Mexico.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of the Company include its corporate overhead, project management, information technology, executive compensation, human resources, legal and accounting expenses. Selling, general and administrative expenses were approximately \$13.1 million and \$12.5 million for the nine months ended September 30, 2011 and 2010.

Domestic selling, general and administrative expenses totaled \$6.5 million for the nine months ended September 30, 2011, compared to \$6.9 million for the same period in 2010, reflecting a decrease of approximately \$400,000 due primarily to salary and related benefit expenses.

International selling, general and administrative expenses totaled \$6.4 million for the nine months ended September 30, 2011, compared to \$5.6 million for the same period in 2010. The increase of approximately \$800,000 was primarily due to salary and other employee related benefit expenses in the markets of Australia, China, Japan, as well as additional cost related to the new subsidiary in Mexico, partially offset by lower expenses in Canada.

Depreciation and Amortization

Depreciation and amortization expenses totaled \$808,000 for the nine months ended September 30, 2011, compared to \$725,000 for the same period in 2010. The increase was primarily due to higher capital expenditures related to software development compared to prior year.

Interest Expense, net

The Company's net interest expense was \$160,000 and \$138,000 for the nine months ended September 30, 2011 and 2010, respectively. The increase was primarily due to the loss of interest income from the Safeway settlement in July of 2010 partially offset by higher debt levels.

Other Income and Expense

Other net income of \$22,000 for the nine months ended September 30, 2011, reflects income from a favorable legal judgment and the sale of the subsidiary in Turkey, partially offset by related legal expenses. The net other expense of \$15,000 for the nine months ended September 30, 2010, is primarily attributable to legal expenses related to the Safeway settlement.

Income Taxes

The income tax provision for the nine months ended September 30, 2011 and 2010 was \$72,000 and \$74,000, respectively. The tax provision resulted primarily from domestic state taxes and for tax provisions related to certain international profits. The Company recognizes minimum federal tax provisions as the Company anticipates utilizing operating loss carry forwards in 2011.

Non-controlling Interest

Net operating profits from the non-controlling interest, from the Company's 51% owned subsidiaries, resulted in a reduction of net income of \$137,000 for the nine months ended September 30, 2011, compared to net operating loss from the non-controlling interest, resulting in an increase of net income of \$20,000 for the nine months ended September 30, 2010.

SPAR Group, Inc. and Subsidiaries

Net Income

The Company reported a net income of \$1.0 million for the nine months ended September 30, 2011, or \$0.05 per share, compared to a net income of \$973,000, or \$0.05 per share, for the corresponding period last year.

Liquidity and Capital Resources

In the nine months ended September 30, 2011, the Company had net income before non-controlling interest of \$1.1 million.

Net cash provided by operating activities was \$2.4 million compared to net cash used in operating activities of \$230,000 for the nine months ended September 30, 2011 and 2010, respectively. The net cash provided by operating activities was due to a reported net income, a reduction in accounts receivable and other assets, partially offset by a reduction in accrued expenses and other liabilities.

Net cash used in investing activities for the nine months ended September 30, 2011, and September 30, 2010, was approximately \$800,000 and \$1.2 million, respectively. The net cash used in investing activities was primarily a result of fixed asset additions and investment for new subsidiary in Mexico.

Net cash used in financing activities for the nine months ended September 30, 2011, was approximately \$848,000 and net cash provided by financing activities was approximately \$581,000 for the nine months ended September 30, 2010, respectively. Net cash used in financing activities in 2011 was primarily a result of payments on lines of credit.

The above activity resulted in an increase in cash and cash equivalents for the nine months ended September 30, 2011, of \$715,000.

At September 30, 2011, the Company had working capital of \$5.5 million, as compared to working capital of \$4.4 million at December 31, 2010. The Company's current ratio was 1.6 and 1.4 at September 30, 2011, and at December 31, 2010, respectively.

Domestic Credit Facility ("Sterling Credit Facility"):

SGRP and certain of its domestic direct and indirect subsidiaries, namely SPAR Marketing Force, Inc., National Assembly Services, Inc., SPAR Group International, Inc., SPAR Trademarks, Inc., SPAR Incentive Marketing, Inc., PIA Merchandising Co., Inc., and SPAR Acquisition, Inc. (each a "Subsidiary Borrower", and together with SGRP, collectively, the "Borrowers"), entered into a Revolving Loan and Security Agreement dated as of July 6, 2010 (the "Loan Agreement"), with Sterling National Bank and Cornerstone Bank as the lenders (the "Lenders"), and issued their Secured Revolving Loan Notes in the original maximum principal amounts of \$5.0 million to Sterling National Bank and \$1.5 million to Cornerstone Bank (the "Notes"), to document and govern its new credit facility with them (the "Sterling Credit Facility"). In June 2011, the Lenders agreed to: (1) reduce the personal guarantee limits as noted below, and (2) extend the maturity of the Sterling Credit Facility until July 2013.

In addition, Mr. Robert G. Brown, a Director, the Chairman and a major stockholder of SGRP, and Mr. William H. Bartels, a Director, the Vice Chairman and a major stockholder of SGRP, have provided personal guarantees of the Sterling Credit Facility totaling \$1,250,000 pursuant to their Limited Continuing Guaranty in favor of the Lenders dated as of July 6, 2010, as amended in June 2011 (the "Limited Guaranty").

Revolving Loans of up to \$6.5 million are available to the Borrowers under the new Sterling Credit Facility based upon the borrowing base formula defined in the Loan Agreement (principally 85% of "eligible" domestic accounts receivable less certain reserves). The Sterling Credit Facility is secured by substantially all of the assets of the Borrowers (other than SGRP's foreign subsidiaries, certain designated domestic subsidiaries, and their respective equity and assets).



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The basic interest rate under the Sterling Credit Facility is equal to the fluctuating Prime Rate of interest published in the Wall Street Journal from time to time plus one and one-half (1.50%) percent per annum, which automatically changes with each change in such rate.

Due of the requirement to maintain a lock box arrangement with the Agent and the Lenders' ability to invoke a subjective acceleration clause at its discretion, borrowings under the Sterling Credit Facility will be classified as current.

The Sterling Credit Facility contains certain financial and other restrictive covenants and also limits certain expenditures by the Borrowers, including, but not limited to, capital expenditures and other investments. At September 30, 2011, the Company was in compliance with such covenants and does not expect to be in violation at future measurement dates. However, there can be no assurances that the Company will not be in violation of certain covenants in the future, and should the Company be in violation; there can be no assurances that the Lenders will issue waivers for any future violations.

International Credit Facilities:

In 2008, the Australian subsidiary, SPARFACTS Australia Pty. Ltd., entered into a revolving line of credit arrangement (as amended in September 2009) with Commonwealth Bank of Australia (CBA) for \$1.5 million (Australian), or approximately \$1.5 million (based upon the exchange rate at September 30, 2011).

On October 20, 2006, SPAR Canada Company, a wholly owned subsidiary, entered into a secured credit agreement with Royal Bank of Canada providing for a Demand Operating Loan for a maximum borrowing of \$750,000 (Canadian) or approximately \$726,000 (based upon the exchange rate at September 30, 2011). The Demand Operating Loan provides for borrowing based upon a formula as defined in the agreement (principally 75% of eligible accounts receivable less certain deductions) and a minimum total debt to tangible net worth covenant. The Company was in compliance with the minimum total debt to tangible net worth covenant under this line of credit at September 30, 2011.

On March 26, 2010 the Company signed a Loan and Security Agreement and a Promissory Note with Michael Anthony Holdings, Inc. for a total of \$500,000 which was used for the acquisition of certain assets of a Canadian company that closed on April 1, 2010. The loan was payable on an interest only basis and matured on March 31, 2011 and was paid in full on that date.

On March 7, 2011, the Japanese subsidiary, SPAR FM Japan, Inc., a wholly owned subsidiary, secured a loan with Mizuho Bank in the amount of 20.0 million Japanese Yen, or approximately \$261,000. The loan is payable in monthly installments of 238,000 Yen or \$3,100 at an interest rate of 0.1% per annum with a maturity date of February 28, 2018. The outstanding balance at September 30, 2011, was approximately 18 million Yen or \$239,000 (based upon the exchange rate at September 30, 2011).

Summary of Company Credit and Other Debt Facilities:

(in thousands)

| September<br>30, 2011 | Average | December<br>31, 2010 | Average |
|-----------------------|---------|----------------------|---------|
|-----------------------|---------|----------------------|---------|

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|  |         | Interest<br>Rate |   | Interest<br>Rate |         |
|--|---------|------------------|---|------------------|---------|
| Credit Facility Loan Balance:                  |         |                  |   |                  |         |
| USA, Sterling Credit Facility and predecessors | \$3,782 | 4.75             | % | \$3,536          | 4.87 %  |
| Australia                                      | 131     | 10.24            | % | 548              | 10.24 % |
| Canada   | 242     | 4.00             | % | 623              | 4.00 %  |
|  | \$4,155 |                  |   | \$4,707          |         |

## SPAR Group, Inc. and Subsidiaries

|                             | September<br>30, 2011 | December<br>31, 2010 |
|-----------------------------|-----------------------|----------------------|
| <b>Unused Availability:</b> |                       |                      |
| USA – Sterling Facility     | \$2,300               | \$1,700              |
| Australia                   | 1,369                 | 952                  |
| Canada                      | 149                   | 87                   |
|                             | \$3,818               | \$2,739              |
| <b>Other Debt:</b>          | \$239                 | \$556                |

The Company's international business model is to partner with local merchandising companies and combine the Company's proprietary software and expertise in the merchandising and marketing services business with their partner's knowledge of the local market. In 2001, the Company established its first subsidiary in Japan and has continued this strategy. As of this filing, the Company is currently operating in 9 countries and has 8 international subsidiaries. Certain of these international subsidiaries are profitable, while others are operating at a loss. In the event of continued losses, the Company may be required to provide additional cash infusions into those subsidiaries with losses.

Management believes that based upon the continuation of the Company's existing credit facilities, projected results of operations, vendor payment requirements and other financing available to the Company (including amounts due to affiliates), sources of cash availability should be manageable and sufficient to support ongoing operations over the next twelve months. However, continued international losses, delays in collection of receivables due from any of the Company's major clients, or a significant reduction in business from such clients could have a material adverse effect on the Company's cash resources and its ongoing ability to fund operations.

#### Certain Contractual Obligations

The following table contains a summary of certain of the Company's contractual obligations by category as of September 30, 2011 (in thousands):

| Contractual<br>Obligations        | Total          | Period in which payments are due |                |              |                      |
|-----------------------------------|----------------|----------------------------------|----------------|--------------|----------------------|
|                                   |                | Less than 1<br>year              | 1-3 years      | 3-5 years    | More than 5<br>years |
| Lines of Credit and<br>Other Debt | \$4,394        | \$4,191                          | \$75           | \$75         | \$53                 |
| Capital Lease<br>Obligations      | 325            | 154                              | 171            | –            | –                    |
| Operating Lease<br>Obligations    | 2,098          | 702                              | 1,306          | 90           | –                    |
| <b>Total</b>                      | <b>\$6,817</b> | <b>\$5,047</b>                   | <b>\$1,552</b> | <b>\$165</b> | <b>\$53</b>          |

## SPAR Group, Inc. and Subsidiaries

## Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company's accounting policies for financial instruments and disclosures relating to financial instruments require that the Company's consolidated balance sheets include the following financial instruments: cash and cash equivalents, accounts receivable, accounts payable and lines of credit. The Company carries current assets and liabilities at their stated or face amounts in its consolidated financial statements, as the Company believes those amounts approximate the fair value for these items because of the relatively short period of time between origination of the asset or liability and their expected realization or payment. The Company monitors the risks associated with asset and liability positions, as well as interest rates. The Company's investment policy objectives require the preservation and safety of the principal, and the maximization of the return on investment based upon its safety and liquidity objectives.

The Company is exposed to market risk related to the variable interest rate on its lines of credit, both in its United States subsidiaries (i.e., the Domestic Merchandising Services Division) and in its International (non-U.S.) subsidiaries (i.e., the International Merchandising Services Division). At September 30, 2011, the Company's outstanding lines of credit and other debt totaled approximately \$4.4 million, as noted in the table below (in thousands):

| Location      | Variable Interest Rate |                |
|---------------|------------------------|----------------|
|               | (1)                    | US Dollars (2) |
| United States | 4.75%                  | \$3,782        |
|               | 0.1%                   |                |
| International | -10.24%                | 612            |
|               |                        | \$4,394        |

(1) Based on interest rate at September 30, 2011.

(2) Based on exchange rate at September 30, 2011.

Based on the 2011 average outstanding borrowings under variable-rate debt, a one-percentage point increase in interest rates would negatively impact pre-tax earnings and cash flows for the nine months ended September 30, 2011, by approximately \$23,000.

The Company has foreign currency exposure with its international subsidiaries. In both 2011 and 2010, these exposures are primarily concentrated in the Australian Dollar, Canadian Dollar and Japanese Yen. International revenues for the nine months ended September 30, 2011 and 2010 were \$22.3 million and \$17.9 million, respectively. The international division reported a net loss of approximately \$332,000 and \$558,000 for the nine months ended September 30, 2011 and 2010, respectively.

In those countries where the Company had risk for foreign currency exposure, the total assets were \$6.9 million and total liabilities were \$4.8 million based on exchange rates at September 30, 2011.

## Item 4. Controls and Procedures

## Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting for the registrant, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Management has designed such internal control over financial reporting by the Company to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America.

The Company's management has evaluated the effectiveness of the Company's internal control over financial reporting using the "Internal Control – Integrated Framework (1992)" created by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework. Based on this evaluation, management has concluded that internal controls over financial reporting were effective as of September 30, 2011.

SPAR Group, Inc. and Subsidiaries

Management's Evaluation of Disclosure Controls and Procedures

The Company's chief executive officer and chief financial officer have each reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report, as required by Exchange Act Rules 13a-15(b) and Rule 15d-15(b). Based on that evaluation, the chief executive officer and chief financial officer have each concluded that the Company's current disclosure controls and procedures are effective to insure that the information required to be disclosed by the Company in reports it files, or submits under the Exchange Act were recorded, processed, summarized and reported within the time period specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls Over Financial Reporting

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls during the nine months covered by this report or from the end of the reporting period to the date of this form 10-Q.

SPAR Group, Inc. and Subsidiaries

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 1A. Risk Factors

Existing Risk Factors

SGRP's Annual Report describes various risk factors applicable to the Company and its businesses in Item 1A under the caption "Risk Factors", which risk factors are incorporated by reference into this Quarterly Report. There have been no material changes in the Company's risk factors since the Company's Annual Report for 2010 on Form 10-K, as filed with the SEC on March 15, 2011.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Item 2(a): Not applicable

Item 2(b): Not applicable

Item 2(c): Not applicable

Item 3. Defaults upon Senior Securities

Item 3(a): Defaults under Indebtedness: None.

Item 3(b): Defaults under Preferred Stock: None.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

31.1 Certification of the CEO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as filed herewith.

31.2 Certification of the CFO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as filed herewith.

32.1 Certification of the CEO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as filed herewith.

32.2 Certification of the CFO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as filed

herewith.

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SPAR Group, Inc. and Subsidiaries

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 7, 2011

SPAR Group, Inc., Registrant

By: /s/ James R. Segreto  
James R. Segreto  
Chief Financial Officer, Treasurer, Secretary  
and duly authorized signatory