

SPAR GROUP INC  
Form 10-Q  
November 21, 2016

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, 2016**.

OR

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

Commission file number: 0-27824

**SPAR Group, Inc.**

(Exact name of registrant as specified in its charter)  
Delaware 33-0684451  
State of Incorporation IRS Employer Identification No.

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

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

Indicate by check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

Edgar Filing: SPAR GROUP INC - Form 10-Q

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

Accelerated Filer  
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 November 11, 2016, there were 20,639,490 shares of Common Stock outstanding.

---

**SPAR Group, Inc.**

Index

**PART I: FINANCIAL INFORMATION**

|                                   |  |    |
|-----------------------------------|--|----|
| Item 1                            | Condensed Consolidated Financial Statements (Unaudited)  |    |
|                                   | Condensed Consolidated Balance Sheets as of September 30, 2016 (Unaudited) and December 31, 2015   | 2  |
|                                   | Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2016 and 2015 | 3  |
|                                   | Unaudited Condensed Consolidated Statement of Equity for the nine months ended September 30, 2016  | 4  |
|                                   | Unaudited Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015                            | 5  |
|                                   | Notes to Unaudited Condensed Consolidated Financial Statements   | 6  |
| Item 2                            | Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources                        | 20 |
| Item 3                            | Quantitative and Qualitative Disclosures about Market Risk   | 27 |
| Item 4                            | Controls and Procedures  | 28 |
| <b>PART II: OTHER INFORMATION</b> |  |    |
| Item 1                            | Legal Proceedings  | 29 |
| Item 1A                           | Risk Factors   | 29 |
| Item 2                            | Unregistered Sales of Equity Securities and Use of Proceeds  | 30 |
| Item 3                            | Defaults upon Senior Securities  | 30 |
| Item 4                            | Mine Safety Disclosures  | 30 |
| Item 5                            | Other Information  | 30 |
| Item 6                            | Exhibits   | 31 |

**SIGNATURES**

32

1

---

**PART I: FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements****SPAR Group, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets***(In thousands, except share and per share data)*

|  | <b>September<br/>30,<br/>2016<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2015</b> |
|--|---|----------------------------------|
| <b>Assets</b>                                  |   |                                  |
| Current assets:                                |   |                                  |
| Cash and cash equivalents                      | \$ 7,502  | \$ 5,718                         |
| Accounts receivable, net                       | 30,782  | 23,203                           |
| Deferred income taxes                          | 532   | 529                              |
| Prepaid expenses and other current assets      | 898   | 661                              |
| Total current assets                           | 39,714  | 30,111                           |
| Property and equipment, net                    | 2,556   | 2,443                            |
| Goodwill                                       | 2,257   | 1,800                            |
| Intangible assets, net                         | 2,154   | 2,551                            |
| Deferred income taxes                          | 6,513   | 5,890                            |
| Other assets                                   | 2,290   | 611                              |
| Total assets                                   | \$ 55,484   | \$ 43,406                        |
| <b>Liabilities and equity</b>                  |   |                                  |
| Current liabilities:                           |   |                                  |
| Accounts payable                               | \$ 5,007  | \$ 2,984                         |
| Accrued expenses and other current liabilities | 12,628  | 7,082                            |
| Accrued expenses due to affiliates             | 989   | 78                               |
| Deferred income taxes                          | 2,566   | 2,154                            |
| Customer deposits                              | 955   | 503                              |
| Lines of credit and short-term loans           | 8,181   | 476                              |
| Total current liabilities                      | 30,326  | 13,277                           |
| Long-term debt and other liabilities           | 12  | 5,731                            |
| Total liabilities                              | 30,338  | 19,008                           |
| Commitments and Contingencies – See Note 8     |   |                                  |
| Equity:  |   |                                  |
| SPAR Group, Inc. equity                        |   |                                  |
| Preferred stock, \$.01 par value:              |   |                                  |
| Authorized and available shares– 2,445,598     |   |                                  |

Edgar Filing: SPAR GROUP INC - Form 10-Q

|   |                  |            |
|---|------------------|------------|
| Issued and outstanding shares–  |                  |            |
| None – September 30, 2016 and December 31, 2015   | –                | –          |
| Common stock, \$.01 par value:  |                  |            |
| Authorized shares – 47,000,000  |                  |            |
| Issued shares – 20,680,717 – September 30, 2016 and December 31, 2015                             | <b>207</b>       | 207        |
| Treasury stock, at cost 42,177 shares – September 30, 2016 and 119,695 shares – December 31, 2015 | <b>(58</b>       | ) (169 )   |
| Additional paid-in capital  | <b>16,041</b>    | 15,871     |
| Accumulated other comprehensive loss  | <b>(3,364</b>    | ) (2,869 ) |
| Retained earnings   | <b>5,746</b>     | 5,662      |
| Total SPAR Group, Inc. equity   | <b>18,572</b>    | 18,702     |
| Non-controlling interest  | <b>6,574</b>     | 5,696      |
| Total equity  | <b>25,146</b>    | 24,398     |
| Total liabilities and equity  | <b>\$ 55,484</b> | \$ 43,406  |

*See accompanying notes.*

**SPAR Group, Inc. and Subsidiaries****Condensed Consolidated Statements of Comprehensive Income (Loss)****(unaudited)***(In thousands, except per share data)*

|   | <b>Three Months<br/>Ended<br/>September 30,<br/>2016</b> |          | <b>Nine Months<br/>Ended<br/>September 30,<br/>2016</b> |            | <b>2015</b> |  |
|---|--|----------|---|------------|-------------|--|
| Net revenues  | <b>\$33,438</b>  | \$28,269 | <b>\$89,781</b>   | \$87,002   |             |  |
| Cost of revenues  | <b>26,162</b>  | 21,555   | <b>69,309</b>   | 66,206     |             |  |
| Gross profit  | <b>7,276</b>   | 6,714    | <b>20,472</b>   | 20,796     |             |  |
| Selling, general and administrative expense                     | <b>6,360</b>   | 6,014    | <b>17,637</b>   | 18,289     |             |  |
| Depreciation and amortization                                   | <b>486</b>   | 471      | <b>1,459</b>  | 1,414      |             |  |
| Operating income  | <b>430</b>   | 229      | <b>1,376</b>  | 1,093      |             |  |
| Interest expense  | <b>51</b>  | 47       | <b>111</b>  | 187        |             |  |
| Other (income), net   | <b>(78 )</b>   | ( 8 )    | <b>(183 )</b>   | (68 )      |             |  |
| Income before income tax expense                                | <b>457</b>   | 190      | <b>1,448</b>  | 974        |             |  |
| Income tax (benefit) expense                                    | <b>(31 )</b>   | 83       | <b>200</b>  | 435        |             |  |
| Net income  | <b>488</b>   | 107      | <b>1,248</b>  | 539        |             |  |
| Net income attributable to non-controlling interest             | <b>(546 )</b>  | (199 )   | <b>(1,164 )</b>   | (676 )     |             |  |
| Net (loss) income attributable to SPAR Group, Inc.              | <b>\$(58 )</b>   | \$(92 )  | <b>\$84</b>   | \$(137 )   |             |  |
| Basic and diluted loss per common share:                        | <b>\$-</b>   | \$-      | <b>\$-</b>  | \$(0.01 )  |             |  |
| Weighted average common shares – basic                          | <b>20,607</b>  | 20,556   | <b>20,580</b>   | 20,562     |             |  |
| Weighted average common shares – diluted                        | <b>20,607</b>  | 20,556   | <b>21,299</b>   | 20,562     |             |  |
| Net income  | <b>\$488</b>   | \$107    | <b>\$1,248</b>  | \$539      |             |  |
| Other comprehensive income (loss):                              |  |          |   |            |             |  |
| Foreign currency translation adjustments                        | <b>206</b>   | (663 )   | <b>(495 )</b>   | (1,413 )   |             |  |
| Comprehensive income (loss)                                     | <b>694</b>   | (556 )   | <b>753</b>  | (874 )     |             |  |
| Comprehensive (income) attributable to non-controlling interest | <b>(546 )</b>  | (199 )   | <b>(1,164 )</b>   | (676 )     |             |  |
| Comprehensive income (loss) attributable to SPAR Group, Inc.    | <b>\$148</b>   | \$(755 ) | <b>\$(411 )</b>   | \$(1,550 ) |             |  |

*See accompanying notes.*

3

---



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

|  | Common Stock  |               | Treasury Stock |                 | Additional<br>Paid-In<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Loss | Retained<br>Earnings | Non-<br>Controlling<br>Interest | Total<br>Equity  |
|--|---------------|---------------|----------------|-----------------|----------------------------------|---|----------------------|---------------------------------|------------------|
|  | Shares        | Amount        | Shares         | Amount          |                                  |   |                      |                                 |                  |
| Balance at January 1, 2016                     | 20,681        | \$ 207        | 120            | \$ (169 )       | \$ 15,871                        | \$ (2,869 )                                   | \$ 5,662             | \$ 5,696                        | \$ 24,398        |
| Share-based compensation                       | –             | –             | –              | –               | 271                              | –   | –                    | –                               | 271              |
| Purchase of treasury shares                    | –             | –             | 11             | (12 )           | –                                | –   | –                    | –                               | (12 )            |
| Reissued treasury shares – RSU's               | –             | –             | (33 )          | 46              | (46 )                            | –   | –                    | –                               | –                |
| Reissued treasury shares – Employee Stock Plan | –             | –             | (2 )           | 3               | (3 )                             | –   | –                    | –                               | –                |
| Exercise of stock options                      | –             | –             | (54 )          | 74              | (52 )                            | –   | –                    | –                               | 22               |
| Distributions to non-controlling investors     | –             | –             | –              | –               | –                                | –   | –                    | (286 )                          | (286 )           |
| Other comprehensive loss                       | –             | –             | –              | –               | –                                | (495 )  | –                    | –                               | (495 )           |
| Net income                                     | –             | –             | –              | –               | –                                | –   | 84                   | 1,164                           | 1,248            |
| <b>Balance at September 30, 2016</b>           | <b>20,681</b> | <b>\$ 207</b> | <b>42</b>      | <b>\$ (58 )</b> | <b>\$ 16,041</b>                 | <b>\$ (3,364 )</b>                            | <b>\$ 5,746</b>      | <b>\$ 6,574</b>                 | <b>\$ 25,146</b> |

*See accompanying notes.*

**SPAR Group, Inc. and Subsidiaries****Condensed Consolidated Statements of Cash Flows****(unaudited)***(In thousands)*

|  | <b>Nine Months<br/>Ended<br/>September 30,<br/>2016      2015</b> |         |
|--|---|---------|
| <b>Operating activities</b>  |   |         |
| Net income   | <b>\$1,248</b>  | \$539   |
| Adjustments to reconcile net income to net cash provided by operating activities |   |         |
| Depreciation and amortization  | <b>1,459</b>  | 1,414   |
| Bad debt expense, net of recoveries  | <b>317</b>  | 409     |
| Share based compensation   | <b>271</b>  | 306     |
| Changes in operating assets and liabilities:                                     |   |         |
| Accounts receivable  | <b>(4,643)</b>  | 4,244   |
| Prepaid expenses and other assets  | <b>(105 )</b>   | (21 )   |
| Accounts payable   | <b>1,000</b>  | (403 )  |
| Accrued expenses, other current liabilities and customer deposits                | <b>2,548</b>  | (1,395) |
| Net cash provided by operating activities  | <b>2,095</b>  | 5,093   |
| <b>Investing activities</b>  |   |         |
| Purchases of property and equipment and capitalized software                     | <b>(1,153)</b>  | (1,238) |
| Purchases of Brazil subsidiary, net of cash                                      | <b>(306 )</b>   | -       |
| Net cash used in investing activities  | <b>(1,459)</b>  | (1,238) |
| <b>Financing activities</b>  |   |         |
| Net borrowing (payments) on lines of credit                                      | <b>2,015</b>  | (473 )  |
| Proceeds from stock options exercised  | <b>22</b>   | 24      |
| Proceeds from local Brazil   | <b>102</b>  | -       |
| Payments on term debt  | <b>(21 )</b>  | (18 )   |
| Purchase of treasury shares  | <b>(12 )</b>  | (109 )  |
| Distribution to non-controlling investors  | <b>(286 )</b>   | (329 )  |
| Net cash provided by (used in) financing activities                              | <b>1,820</b>  | (905 )  |
| Effect of foreign exchange rate changes on cash                                  | <b>(672 )</b>   | (1,122) |
| Net change in cash and cash equivalents  | <b>1,784</b>  | 1,828   |
| Cash and cash equivalents at beginning of year                                   | <b>5,718</b>  | 4,382   |
| Cash and cash equivalents at end of period                                       | <b>\$7,502</b>  | \$6,210 |
| <b>Supplemental disclosure of cash flows information</b>                         |   |         |
| Interest paid  | <b>\$108</b>  | \$176   |

|                   |              |       |
|-------------------|--------------|-------|
| Income taxes paid | <b>\$126</b> | \$114 |
|-------------------|--------------|-------|

*See accompanying notes.*

5

---

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited)

## 1. Basis of Presentation

The unaudited, interim condensed consolidated financial statements of SPAR Group, Inc., a Delaware corporation ("SGRP"), and its subsidiaries (together with SGRP, collectively, the "Company" or the "SPAR Group"), accompanying this Quarterly Report on Form 10-Q for the quarter ended September 30, 2016 (this "Quarterly Report"), 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. The condensed consolidated balance sheet as of December 31, 2015 has been compiled from the Company's audited consolidated balance sheet as of such date. In the opinion of management, all normal and recurring adjustments considered necessary for a fair presentation have been included in these interim financial statements. However, these interim financial statements should be read in conjunction with the annual consolidated financial statements and notes thereto for the Company as contained in the SGRP's Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the Securities and Exchange Commission (the "SEC") on March 30, 2016 (the "2015 Annual Report"), and SGRP's Proxy Statement for its 2016 Annual Meeting of Stockholders as filed with the SEC on April 27, 2016 (the "2016 Proxy Statement"). Particular attention should be given to Items 1 and 1A of the 2015 Annual Report respecting the Company's Business and Risk Factors, respectively, and the following parts of SGRP's 2016 Proxy Statement: (i) *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT*, (ii) *CORPORATE GOVERNANCE*, (iii) *EXECUTIVE OFFICERS, COMPENSATION, DIRECTORS AND OTHER INFORMATION* and (iv) *EXECUTIVE COMPENSATION, EQUITY AWARDS AND OPTIONS*. The Company's results of operations for the interim period are not necessarily indicative of its operating results for the entire year.

## 2. Business and Organization

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

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

As of September 30, 2016, the Company operates in 10 countries and divides its operations into two reportable segments: its Domestic Division, which provides those services in the United States of America since certain of its predecessors were formed in 1979, and its International Division, which began operations in May 2001 and provides similar merchandising, marketing, audit and in-store event staffing services in Japan, Canada, South Africa, India, China, Australia, Mexico, Turkey and Brazil.

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

**3. Earnings Per Share**

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

|  | <b>Three Months<br/>Ended</b> |                | <b>Nine Months<br/>Ended</b>  |                  |
|--|-------------------------------|----------------|-------------------------------|------------------|
|  | <b>September 30,<br/>2016</b> | <b>2015</b>    | <b>September 30,<br/>2016</b> | <b>2015</b>      |
| Numerator:   |                               |                |                               |                  |
| Net (loss) income attributable to SPAR Group, Inc.                       | <b>\$(58 )</b>                | <b>\$(92 )</b> | <b>\$84</b>                   | <b>\$(137 )</b>  |
| Denominator:   |                               |                |                               |                  |
| Weighted average shares used in basic net income per share calculation   | <b>20,607</b>                 | 20,556         | <b>20,580</b>                 | 20,562           |
| Weighted average shares used in diluted net income per share calculation | <b>20,607</b>                 | 20,556         | <b>21,299</b>                 | 20,562           |
| Basic and diluted net (loss) income per common share                     | <b>\$-</b>                    | <b>\$-</b>     | <b>\$-</b>                    | <b>\$(0.01 )</b> |

For the three month period ended September 30, 2016, 696,000 vested and non-vested stock options were not included in the calculation because they would have had an anti-dilutive effect. For the three and nine months ended September 30, 2015, 1,008,000 and 1,016,000 vested and non-vested options were not included due to their anti-dilutive effect.

**4. Credit Facilities***Sterling Credit Facility:*

SGRP and certain of its US and Canadian subsidiaries, (namely SPAR Marketing Force, Inc., SPAR Assembly & Installation, Inc. (f/k/a SPAR National Assembly Services, Inc.), SPAR Group International, Inc., SPAR Trademarks, Inc., SPAR Acquisition, Inc., SPAR Canada, Inc. and SPAR Canada Company) (together with SGRP, the "Borrowers"), are parties to a Revolving Loan and Security Agreement dated as of July 6, 2010, as amended (as amended, the "Sterling Loan Agreement"), with Sterling National Bank (the "Lender"), and their Secured Revolving Loan Note in the amended maximum principal amounts of \$8.5 million (see below) to Sterling National Bank (as amended, the "Sterling Note"), to document and govern their credit facility with the Lender (including such agreement and note, the "Sterling Credit Facility"). The Sterling Credit Facility as amended effective September 28, 2015 currently is scheduled to expire and the Borrowers' loans thereunder will become due on July 6, 2017 (with no early termination fee).

The Sterling Loan Agreement currently requires the Borrowers to pay interest on the loans thereunder equal to the Agent's floating Prime Rate (as defined in such agreement) minus one half of one percent (0.5%) per annum, and a fee on the maximum unused line thereunder equal to one-eighth of one percent (0.125%) per annum.

Revolving loans of up to \$8.5 million are available to the Borrowers under the Sterling Credit Facility based upon the borrowing base formula defined in the Sterling Loan Agreement (principally 85% of "eligible" US and Canadian accounts receivable less certain reserves). The Sterling Credit Facility is secured by substantially all of the assets of the Borrowers (other than the Company's non-Canadian foreign subsidiaries, certain designated domestic subsidiaries, and those subsidiaries' respective equity and assets).

The amendment to the Sterling Credit Facility effective as of September 28, 2015, among other things, extended the scheduled term of the Sterling Credit Facility to July 6, 2017 (with no early termination fee), increased the maximum principal amounts of Sterling's commitment under the Sterling Loan Agreement to \$8.5 million, and provided for the amendment and restatement of the Sterling Note with a new \$8.5 million note from the Borrowers in replacement of the old notes and made other changes to its covenant and collateral formulas.

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

The Sterling Loan Agreement requires the Borrowers to maintain certain financial covenants, including maintenance by the Borrowers of a minimum combined tangible net worth of \$3.4 million and minimum consolidated tangible net worth of \$4.8 million, with those figures increasing by at least 50% of combined and consolidated net profit each year, respectively. In addition, the Borrowers and the Company must not exceed a maximum combined indebtedness to tangible net worth ratio of 3.0 to 1.0, and the Borrowers must maintain a minimum fixed charge coverage ratio of 1.5 to 1.0. Also, capital expenditures for the Borrowers cannot exceed \$2.0 million during any fiscal year, and, on a consolidated basis, the Company's year-end operations may not result in a loss or deficit, as determined in accordance with GAAP. The Company was not in compliance with the Fixed Charge Ratio covenant at September 30, 2016, however a waiver was obtained from Sterling Bank on November 18, 2016.

**International Credit Facilities:**

SPARFACTS Australia Pty. Ltd., has a secured line of credit facility with Oxford Funding Pty Ltd. for \$1.2 million (Australian) or approximately \$916,000 USD (based upon the exchange rate at September 30, 2016). The facility provides for borrowing based upon a formula, as defined in the agreement (principally 80% of eligible accounts receivable less certain deductions). The agreement is on a month to month basis at the Company's request. The outstanding balance at September 30, 2016, was approximately \$448,000 (Australian) or \$342,000 USD (based on the exchange rate at September 30, 2016).

On March 7, 2011, the Japanese subsidiary, SPAR FM Japan, Inc., a wholly owned subsidiary, secured a term loan with Mizuho Bank in the amount of approximately 20.0 million Yen (Japanese) or \$198,000 USD. The loan is payable in monthly installments of 238,000 Yen or \$2,400 USD at an interest rate of 0.1% per annum with a maturity date of February 28, 2018. The outstanding balance at September 30, 2016, was approximately 4.1 million Yen or \$40,000 USD (based upon the exchange rate at September 30, 2016).

SPAR Todopromo has secured a line of credit facility with BBVA Bancomer Bank for 5.0 million pesos or approximately \$257,000 USD (based upon the exchange rate at September 30, 2016). The revolving line of credit was secured on March 15, 2016 with a contract for 24 months. The variable interest rate is TIIE (Interbank Interest Rate) +4% which results in an actual interest rate of 8.5% at the end of September. The outstanding balance at September 30, 2016 was 5.0 million pesos or \$257,000 USD.



The Company had scheduled future maturities of loans as of September 30, 2016, approximately as follows (dollars in thousands):

|                         | <b>Interest<br/>Rate as of<br/>September<br/>30, 2016</b> | <b>October -<br/>December 2016</b> | <b>2017</b> | <b>2018</b> |
|-------------------------|---|------------------------------------|-------------|-------------|
| Mizuho Bank             | 0.1 %   | \$ 7                               | \$28        | \$ 5        |
| Sterling National Bank  | 3.0 %   | –                                  | 7,554       | –           |
| Oxford Funding Pty Ltd. | 6.3 %   | 342                                | –           | –           |
| BBVA Bankcomer          | 8.5 %   | 257                                | –           | –           |
| Total                   |   | \$ 606                             | \$7,582     | \$ 5        |

|                             | <b>September<br/>30, 2016</b> | <b>December<br/>31, 2015</b> |
|-----------------------------|-------------------------------|------------------------------|
| <u>Unused Availability:</u> |                               |                              |
| United States               | \$ 317                        | \$ 1,635                     |
| Australia                   | 574                           | 640                          |
| Mexico                      | –                             | –                            |
| Total Unused Availability   | \$ 891                        | \$ 2,275                     |

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

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 year. However, 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.

## **5. Related-Party Transactions**

SGRP's policy respecting approval of transactions with related persons, promoters and control persons is contained in the SPAR Group Code of Ethical Conduct for its Directors, Senior Executives and Employees Amended and Restated (as of) August 13, 2015 (the "Ethics Code"). The Ethics Code is intended to promote and reward honest, ethical, respectful and professional conduct by each Covered Person (as defined in the Ethics Code in his or her position with the Company anywhere in the world, including (among other things) serving each customer, dealing with each vendor and treating each other with integrity and respect, and behaving honestly, ethically and professionally with each customer, each vendor, each other and the Company. Article II of the Ethics Code specifically prohibits various forms of self-dealing and collusion and Article V of the Ethics Code generally prohibits each "Covered Person" (including SGRP's officers and directors) from engaging in any business activity that conflicts with his or her duties to the Company, and directs each "Covered Person" to avoid any activity or interest that is inconsistent with the best interests of the SPAR Group, in each case except for any "Approved Activity" (as such terms are defined in the Ethics Code). Examples of violations include (among other things) having any ownership interest in, acting as a director or officer of or otherwise personally benefiting from business with any competitor, customer or vendor of the Company other than pursuant to any Approved Activity. Approved Activities include (among other things) any contract with an affiliated person (each an "Approved Affiliate Contract") or anything else disclosed to and approved by SGRP's Board of Directors (the "Board"), its Governance Committee or its Audit Committee, as the case may be, as well as the ownership, board, executive and other positions held in and services and other contributions to affiliates of SGRP and its subsidiaries by certain directors, officers or employees of SGRP, any of its subsidiaries or any of their respective family members. The Company's senior management is generally responsible for monitoring compliance with the Ethics Code and establishing and maintaining compliance systems, including conflicting relationships and transactions, subject to the review and oversight of SGRP's Governance Committee as provided in clause IV.11 of the Governance Committee's Charter, and SGRP's Audit Committee as provided in clause I.2(1) of the Audit Committee's Charter. The Governance Committee and Audit Committee each consist solely of independent outside directors.

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

***Domestic Related Party Services:***

SPAR Business Services, Inc. ("SBS"), SPAR Administrative Services, Inc. ("SAS"), and SPAR InfoTech, Inc. ("SIT"), are affiliates of SGRP but are not part of the consolidated Company. Mr. Robert G. Brown, a Director, the Chairman and a major stockholder of SGRP, and Mr. William H. Bartels, a Director and the Vice Chairman of the Company and a major stockholder of SGRP, are the sole stockholders of SBS. Mr. Brown is the sole stockholder of SIT. Mr. Brown is a director and officer of SBS and SIT. Mr. Bartels is a director and officer of SAS. The stockholders of SAS were Mr. Bartels and Mr. Brown, and as of January 1, 2015, Mr. Brown had transferred all of his ownership to parties related to Mr. Brown, each of whom are considered affiliates of the Company for related party purposes because of their family relationships with Mr. Brown.

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

The Company had expenses of \$19.7 million and \$18.9 million for the nine months ended September 30, 2016 and 2015, respectively (each "Total Domestic Field Cost"), for the execution of the field merchandising, auditing, assembly and other specialists (each a "Field Specialist") who execute the services provided by the Company to its domestic clients. SBS, through the use as needed of approximately 6,000 of its available Field Specialists in the U.S.A., provided a majority of all of the domestic Field Specialists used by the Company (which amounted to approximately 78% and 83% of the Company's Total Domestic Field Cost for the nine months ended September 30, 2016 and 2015, respectively). SAS, through the use of its 59 full-time national, regional and district administrators, provided substantially all of the domestic field administrative services used by the Company (which amounted to approximately 92% and 90% of the Company's total domestic field administrative service cost for the nine months ended September 30, 2016 and 2015, respectively).

Pursuant to the terms of the Amended and Restated Field Service Agreement with SBS dated as of January 1, 2004, as amended in 2011, and the Amended and Restated Field Management Agreement with SAS dated as of January 1, 2004 (each a "Prior Agreement"), defined reimbursable expenses and established the "Cost Plus Fee" arrangement where the Company paid SBS and SAS for their costs of providing those services plus a fixed percentage of such reimbursable expenses (the "Cost Plus Fee"). The parties have had negotiations respecting replacement agreements since the Prior Agreements expired on November 30, 2014.

The Company and SBS have agreed in principle to a Cost Plus Fee to 2.96% of SBS's reimbursable expenses as noted above. This agreement in principle went into effect on and has applied since December 1, 2014. A new SBS agreement is being prepared, which will be subject to contractual terms and provisions reasonably acceptable to the parties.

No SBS compensation for Mr. Brown has been reimbursed to date by the Company, and no such salary reimbursements were made under SBS's Prior Agreement. Although recently requested by SBS, those reimbursements have not been agreed upon or authorized by the Company. However, since SBS is a "Subchapter S" corporation and owned by Messrs. Brown and Bartels, all income from SBS is allocated to them.

On June 14, 2016, SAS and SMF entered into a new Field Administration Agreement (the "SAS Agreement"), a copy of which was filed with the Company's Current Report on Form 8-K as filed with the SEC on June 20, 2016. In order to provide continuity with SAS' Prior Agreement, the SAS Agreement is effective and governs the relationship of the parties as of December 1, 2014, and amends, restates and completely replaces SAS' Prior Agreement. The SAS

Agreement more clearly defines reimbursable expenses, exclusions and procedures and continues the indemnifications and releases provided by SAS' Prior Agreement (which indemnifications and releases were and are comparable to those applicable to SGRP's directors and executive officers under its By-Laws and applicable law). Significantly, the SAS Agreement reduced the Cost Plus Fee from 4% to 2% effective as of June 1, 2016.

SGRP's Audit Committee has approved the SAS Agreement pursuant to its specific duty and responsibility to review and approve the overall fairness of all material related-party transactions, as more fully provided above in this Note 5 to the Company's Condensed Consolidated Financial Statements.

No salary reimbursements for Mr. Bartels have been included in such SAS reimbursable expenses or Cost Plus Fee, as such salary reimbursements were not made under the SAS's Prior Agreement and have not been included in the new SAS Agreement approved by the Audit Committee (as required under related party transaction rules). However, since SAS is a "Subchapter S" corporation and owned by Mr. Bartels and relatives of Mr. Brown, all income from SAS is allocated to them.

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

SBS renders the services of independent contractors to provide field merchandising, auditing, assembly and other services (such as "Field Specialist"). The appropriateness of SBS's treatment of its Field Specialists as independent contractors has been periodically subject to challenge (both currently and historically) by various states and others, and SBS's expenses of defending those challenges and other litigation have been paid by the Company (consistent with the Prior Agreements and to endeavor to manage related potential risks). See Note 8 to the Condensed Consolidated Financial Statements – *Commitments and Contingencies*, below. The Company paid SBS for its legal expenses in defending all of its litigation in the amounts of \$143,920 and \$116,635 for the three month periods ended September 30, 2016 and 2015, respectively, and \$586,836 and \$383,971 for the nine month periods ended September 30, 2016, and 2015, respectively.

National Merchandising Services, LLC ("NMS"), is a consolidated domestic subsidiary of the Company and is owned jointly by SGRP through its indirect ownership of 51% of the NMS membership interests and by National Merchandising of America, Inc. ("NMA"), through its ownership of the other 49% of the NMS membership interests. Mr. Edward Burdekin is the Chief Executive Officer and President and a director of NMS and also is an executive officer and director of NMA and the sole member and manager of National Retail Source, LLC ("NRS"). Ms. Andrea Burdekin, Mr. Burdekin's wife, is the sole stockholder and a director of NMA and a director of NMS. NRS and NMA are affiliates of the Company but are not consolidated with the Company. NMS commenced operations as of September 1, 2012.

NRS provided a substantial amount of the domestic merchandising specialist field force used by NMS during 2015. Pursuant to the terms of the Master Field Services Agreement dated as of August 1, 2013 (the "NRS Services Agreement"), NMS received merchandising services from NRS through the use of field merchandising specialists during 2015. For those services, the Company had agreed to reimburse NRS for its total costs of providing those services and to pay NRS a fee equal to 2% of its total costs (the "Plus 2% Fee"). Those costs included all field and administrative costs and expenses (effectively including workers compensation insurance expenses) of NRS but exclude certain legal and other administrative expenses. Accordingly, no salary reimbursement for Mr. Burdekin or Ms. Burdekin were included in such reimbursable costs or Plus 2% Fee.

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

In 2015, NRS provided a substantial amount of the domestic merchandising specialist field force used by NMS and 5% of all of the domestic merchandising specialist field force used by the Company for the nine months ended September 30, 2015. The total Plus 1% Fee earned by NRS for services rendered was approximately \$20,000 for the nine months ended September 30, 2015. As of December 2015, NMS no longer uses NRS but uses field merchandising services from a non-affiliated third-party provider, but NMS could once again use NRS in the future.

***International Related Party Services:***

SGRP Meridian (Pty), Ltd. ("Meridian") is a consolidated international subsidiary of the Company and is owned 51% by SGRP and 49% by the following individuals: Mr. Brian Mason, Mr. Garry Bristow, and Mr. Adrian Wingfield. Mr. Mason is President and a director and Mr. Bristow is an officer and director of Meridian. Mr. Mason is also an officer and director and shareholder of Merhold Property Trust ("MPT"). Mr. Mason and Mr. Bristow are both officers and directors and both are shareholders of Merhold Cape Property Trust ("MCPT"). Mr. Mason, Mr. Bristow and Mr. Wingfield are all officers and shareholders of Merhold Holding Trust ("MHT") which provides similar services like MPT. MPT owns the building where Meridian is headquartered and also owns two vehicles both of which are subleased to Meridian. MCPT provides a fleet of 126 vehicles to Meridian under a 4 year lease program. These leases are provided to Meridian at local market rates included in the summary table below.

SGRP NDS Tanitim Ve Danismanlik A.S. ("NDS") is a consolidated international subsidiary of the Company and is owned 51% by SGRP and 49% by Mr. Medet Yilmaz and Ms. Nurgül Yilmaz. Mr. Yilmaz is President and a director and Ms. Yilmaz is an officer and director of NDS. They are both officers and directors of NDS Tanitim Danismanlik Hizmetleri Gida Tekstil Turizm Pazarlama Ticaret Limited Sirketi ("NDS Tanitim") and NDS Reklam Tanitim Ve Danismanlik Hizmetleri Pazarlama Ticaret Limited Sirketi ("NDS Reklam"). Mr. and Ms. Yilmaz are shareholders of NDS Tanitim and NDS Reklam. NDS Tanitim provided NDS field administration services while NDS Reklam provided NDS field merchandising services both at local market rates through May 2015 at which time NDS assumed these service responsibilities.

SPAR Todopromo is a consolidated international subsidiary of the Company and is owned 51% by SGRP and 49% by the following individuals: Mr. Juan F. Medina Domenzain, Mr. Juan Medina Staines, Mr. Julio Cesar Hernandez Vanegas, and Mr. Jorge Medina Staines. Mr. Juan F. Medina Domenzain is an officer and director of SPAR Todopromo and is also majority shareholder of CONAPAD ("CON") which supplies administrative and operational consulting support to SPAR Todopromo.

At the end of August, Mr. Juan F. Medina Domenzain ("JFMD"), partner in SPAR Todopromo, purchased a warehouse that was leased by SPAR Todopromo. He is leasing the use of the warehouse to SPAR Todopromo for the same amount per month as the prior warehouse owner. He currently has a rental contract for the rest of the year with SPAR Todopromo and a new contract is expected to be signed in January, 2017 at current market rates.

The Company continues to purchase services from SBS, SAS, NRS, MPT, MCPT, MHT, NDS Tanitim, NDS Reklam, CON and JFMD because it believes the value of services it receives from them are at least as favorable to the Company as it could obtain from non-affiliated providers of similar services. The Company believes it is the largest and most important customer of SBS, SAS, NRS, MPT, MCPT, MHT, NDS Tanitim, NDS Reklam, CON and JFMD (and from time to time may be their only customer), and accordingly the Company generally has been able to negotiate better terms, receives more personal and responsive service and is more likely to receive credits and other financial accommodations from SBS, SAS, NRS, MPT, MCPT, MHT, NDS Tanitim, NDS Reklam, CON and JFMD than the Company could reasonably expect to receive from an unrelated service provider who has significant other customers and business. SBS, SAS and NRS affiliate contracts and arrangements are annually reviewed and considered for approval by SGRP's Audit Committee, subject to the ongoing negotiations as described above.



SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

**Summary of Related Party Services:**

The following costs of affiliates were charged to the Company (in thousands):

|   | <b>Three Months<br/>Ended</b> |             | <b>Nine Months<br/>Ended</b>  |             |
|---|-------------------------------|-------------|-------------------------------|-------------|
|   | <b>September 30,<br/>2016</b> | <b>2015</b> | <b>September 30,<br/>2016</b> | <b>2015</b> |
| Services provided by affiliates:              |                               |             |                               |             |
| Field merchandiser and other expenses (SBS)   | <b>\$5,491</b>                | \$5,022     | <b>\$15,828</b>               | \$16,034    |
| Field administration and other expenses (SAS) | <b>\$1,011</b>                | \$1,080     | <b>\$3,138</b>                | \$3,334     |
| Field merchandiser expenses (NMA and NRS)     | <b>\$-</b>                    | \$471       | <b>\$-</b>                    | \$1,038     |
| Office and vehicle rental expenses (MPT)      | <b>\$8</b>                    | \$1         | <b>\$32</b>                   | \$30        |
| Vehicle rental expenses (MCPT)                | <b>\$245</b>                  | \$197       | <b>\$618</b>                  | \$757       |
| Office and vehicle rental expenses (MHT)      | <b>\$34</b>                   | \$39        | <b>\$85</b>                   | \$89        |
| Field administration expenses (NDS Tanitim)   | <b>\$-</b>                    | \$-         | <b>\$-</b>                    | \$15        |
| Field merchandiser expenses (NDS Reklam)      | <b>\$1</b>                    | \$63        | <b>\$1</b>                    | \$180       |
| Consulting and administrative services (CON)  | <b>\$74</b>                   | \$89        | <b>\$241</b>                  | \$279       |
| Warehouse rental (JFMD)                       | <b>\$3</b>                    | \$-         | <b>\$3</b>                    | \$-         |
| Total services provided by affiliates         | <b>\$6,867</b>                | \$6,962     | <b>\$19,946</b>               | \$21,756    |

| Accrued expenses due to affiliates (in thousands): | <b>September<br/>30,<br/>2016</b> | <b>December<br/>31,<br/>2015</b> |
|--|-----------------------------------|----------------------------------|
| Total accrued expenses due to affiliates           | <b>\$ 989</b>                     | \$ 78                            |

**Other Related Party Transactions and Arrangements**

In July 1999, SPAR Marketing Force, Inc. ("SMF"), SBS and SIT entered into a perpetual software ownership agreement providing that each party independently owned an undivided share of and had the right to unilaterally license and exploit their "Business Manager" Internet job scheduling software (which had been jointly developed by such parties), and all related improvements, revisions, developments and documentation from time to time voluntarily

made or procured by any of them at its own expense. Business Manager and its other proprietary software and applications are used by the Company for (among other things) the scheduling, tracking, coordination and reporting of its merchandising and marketing services and are accessible via the Internet or other applicable telecommunication network by the authorized representatives of the Company and its clients through their respective computers and mobile devices. In addition, SPAR Trademarks, Inc. ("STM"), SBS and SIT entered into separate perpetual trademark licensing agreements whereby STM has granted non-exclusive royalty-free licenses to SIT and SBS (and through them to their commonly controlled subsidiaries and affiliates by sublicenses, including SAS) for their continued use of the name "SPAR" and certain other trademarks and related rights of STM, a wholly owned subsidiary of SGRP. SBS and SAS provide services to the Company, as described above, SIT assisted in the Brazilian acquisition, as described below, and SIT no longer provides services to and does not compete with the Company.

Through arrangements with the Company, SBS, SAS and other companies owned by Mr. Brown or Mr. Bartels participate in various benefit plans, insurance policies and similar group purchases by the Company, for which the Company charges them their allocable shares of the costs of those group items and the actual costs of all items paid specifically for them. All such transactions between the Company and the above affiliates are paid and/or collected by the Company in the normal course of business.

In addition to the above, SAS purchases insurance coverage for worker compensation, casualty and property insurance risk for itself, SBS for its field merchandising specialists that require such insurance coverage and the Company from Affinity Insurance, Ltd. ("Affinity"). SAS owns a minority (less than 1%) of the common stock in Affinity. The Affinity insurance premiums for such coverage are ultimately charged to SAS, SBS (and through SBS to its covered field merchandising specialists) and the Company based on the contractual arrangements of the parties.

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

***Related Party Transactions and Arrangements in the Brazil Acquisition***

The following related party transactions occurred and arrangements established in connection with the Company's September 2016 acquisition in Brazil of the NM Companies (as defined and more fully described in Note 10 to Consolidated Financial Statements - *Purchase of Interests in Subsidiaries*, below).

On September 8, 2016, the Company (through its Cayman Islands subsidiary) acquired 100% ownership of SGRP Brasil Participações Ltda. ("SGRP Holdings"), a Brazilian limitada (which is a form of limited liability company), from its affiliate, SPAR Infotech, Inc. ("SIT") (see below), at cost (including approved expenses). SGRP Holdings then completed the formation and acquired a majority of the stock of SPAR Brasil Serviços de Merchandising e Tecnologia S.A., a Brazilian corporation ("SPAR BSMT").

SGRP Holdings, JK Consultoria Empresarial Ltda.-ME, a Brazilian limitada ("JKC"), and Earth Investments, LLC, a Nevada limited liability company ("EILLC"), entered into a Joint Venture Agreement respecting SPAR BSMT dated and effective as of September 13, 2016 (the "JV Agreement"). See below respecting the ownership and related party status of JKC and EILLC. The JV Agreement (among other things) provided for the NM Acquisition described (and defined) below, provided for the capitalization of and loans to SPAR BSMT to fund the NM Acquisition and its working capital, and established terms for the election of officers and directors and governance of SPAR BSMT. In addition, the JV Agreement provided for the issuance of shares by SPAR BSMT in the necessary amounts to give SGRP Holdings 51%, JKC 39% and EILLC 10% of the outstanding shares of SPAR BSMT's stock. Under the JV Agreement, SPAR BSMT has five directors, three of which are nominated by SGRP Holdings, one of which is nominated by JKC and one of which is nominated by EILLC.

JKC is owned by Mr. Jonathan Dagues Martins, a Brazilian citizen and resident ("JDM") and his sister, Ms. Karla Dagues Martins, a Brazilian citizen and resident. JDM is the Chief Executive Officer and President of each SPAR Brazil company pursuant to a Management Agreement between JDM and SPAR BSMT dated September 13, 2016. JDM also is a director of SPAR BSMT. Accordingly, JKC and JDM are each a related party in respect of the Company. JKC and SGRP Holdings are parties to separate Loan Agreements with SPAR BSMT dated September 14, 2016, pursuant to which SGRP Holdings loaned R\$1,400,000 (approximately US\$448,000) and JKC loaned R\$453,673 (approximately US\$145,175) to SPAR BSMT as required by the JV Agreement. JKC funded that loan in part through a loan of R\$120,423 (approximately US\$38,700) to JKC from SGRP Holdings pursuant to a Loan Agreement between them dated September 14, 2016.

EILLC is owned by Mr. Peter W. Brown, a citizen and resident of the USA ("PWB"). PWB is an officer and employee of the Company's affiliate, SIT which is owned by SGRP's Chairman, Mr. Robert G. Brown, PWB is an official observer at the meetings of SGRP's Board, and PWB also is the nephew of Mr. Robert G. Brown. PWB also is a director of SPAR BSMT. Accordingly, PWB and EILLC are each a related party in respect of the Company. In consideration of PWB's efforts in finding and pursuing the NM Acquisition, the Company agreed to grant his company, EILLC, a 10% interest in SPAR BSMT, have SGRP Holdings take over and make the initial loans to SPAR BSMT that would otherwise have been required to have been made by EILLC (aggregating R\$116,326 or approximately US\$37,200). The Company also agreed to reimburse Infotech for PWB's approved expenses.

The NM Acquisition and associated related party transactions were reviewed and approved by the Audit Committee of SGRP's Board of Directors.

Company paid SBS for its legal expenses in defending all of its litigation in the amounts of \$143,920 and \$116,635 for the three month periods ended September 30, 2016 and 2015, respectively, and \$586,836 and \$383,971 for the nine month periods ended September 30, 2016, and 2015, respectively.

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

## **6. Preferred Stock**

SGRP's certificate of incorporation authorizes it to issue 3,000,000 shares of preferred stock with a par value of \$0.01 per share (the "SGRP Preferred Stock"), which may have such preferences and priorities over the SGRP Common Stock and other rights, powers and privileges as the Company's Board of Directors may establish in its discretion from time to time. The Company has created and authorized the issuance of a maximum of 3,000,000 shares of Series A Preferred Stock pursuant to SGRP's Certificate of Designation of Series "A" Preferred Stock (the "SGRP Series A Preferred Stock"), which have dividend and liquidation preferences, have a cumulative dividend of 10% per year, are redeemable at the Company's option and are convertible at the holder's option (and without further consideration) on a one-to-one basis into SGRP Common Stock. The Company issued 554,402 of SGRP shares to affiliated retirement plans which were all converted into common shares in 2011 (including dividends earned thereon), leaving 2,445,598 shares of remaining authorized preferred stock. At September 30, 2016, no shares of SGRP Series A Preferred Stock were issued and outstanding.

## **7. Stock-Based Compensation and Other Plans**

SGRP has granted restricted stock and stock option awards to its eligible directors, officers and employees and certain employees of its affiliates respecting shares of Common Stock issued by SGRP ("SGRP Shares") pursuant to SGRP's 2008 Stock Compensation Plan (as amended, the "2008 Plan"), which was approved by SGRP's stockholders in May of 2008 and 2009. The 2008 Plan provides for the granting of restricted SGRP shares, stock options to purchase SGRP shares (either incentive or nonqualified), 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 option, restricted share awards, and performance stock units. As of September 30, 2016, approximately 700,000 SGRP shares were available for Award grants under the amended 2008 Plan. In the third quarter, there were 75,000 options awarded to officers, 50,000 options awarded to Peter W. Brown, a consultant and related party to the Company, and 400,000 options awarded to the new President and CEO of SPAR Group, Inc. In addition, the CEO was awarded 25,000 shares of restricted stock in the quarter.

The Company recognized \$90,000 and \$119,000 in stock-based compensation expense relating to stock option awards during the three month periods ended September 30, 2016 and 2015, respectively. The tax benefit available from stock based compensation expense related to stock option during the three months ended September 30, 2016 and 2015 was approximately \$34,000 and \$45,000 respectively. The Company recognized \$232,000 and \$290,000 in stock-based compensation expense relating to stock option Awards during the nine month periods ended September 30, 2016 and 2015, respectively. The tax benefit, available to the Company, from stock based compensation expense related to stock options during the nine months ended September 30, 2016 and 2015 was approximately \$85,000 and \$110,000, respectively. However, since the Company has NOL's available for the next several years, these tax benefits have not been realized as of this report. As of September 30, 2016, total unrecognized stock-based compensation expense related to stock options was \$674,000.

During the three months ended September 30, 2016 and 2015, the Company recognized approximately \$9,000 and \$15,000, respectively of stock based compensation expense related to restricted stock. The tax benefit available to the Company from stock based compensation expense related to restricted stock during the three months ended September 30, 2016 and 2015 was approximately \$3,500 and \$5,600, respectively. During the nine months ended September 30, 2016 and 2015, the Company recognized approximately \$39,000 and \$35,000, respectively, of stock-based compensation expense related to restricted stock. The tax benefit, available to the Company, from stock based compensation expense related to restricted stock during the nine months ended September 30, 2016 and 2015 was approximately \$14,800 and \$13,500, respectively. However, since the Company has NOL's available for the next several years, these tax benefits have not been realized as of this report. As of September 30, 2016, total unrecognized stock-based compensation expense related to unvested restricted stock Awards was \$118,000.

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

## **8. Commitments and Contingencies**

The Company is a party to various legal actions and administrative proceedings arising in the normal course of business, and through its insurance programs, the Company endeavors to manage any underlying or related potential risk.

The Company executes the services it provides to its domestic clients through independent field merchandising, auditing, assembly and other specialists (each a "Field Specialist"), the vast majority of whom are provided by SBS. For affiliated relationships, contractual details, and payment amounts, see Note 5 to the Condensed Consolidated Financial Statements – *Related Party Transactions - Domestic Related Party Services*, in this Quarterly Report, above. The appropriateness of SBS's treatment of its Field Specialists as independent contractors has been periodically subject to challenge (both currently and historically) by various states and others, and SBS's expenses of defending those challenges and other litigation have been paid by the Company (consistent with their Prior Agreements and to endeavor to manage related potential risks). That treatment is being challenged currently in a California class action lawsuit where the State Court separated the issues of independent contractor status and damages, tried the status issue first, and ruled that the Field Specialists were employees because (among other things) they failed to sufficiently exercise their independence. The second stage of the trial will be the determination of damages, if any. When a decision has been reached on those damages, the liability and damage decisions can be appealed to a higher court. There can be no assurance that SBS will succeed in defending any such challenge, the legal expenses of prolonged litigation and appeals could continue to be (and have from time to time been) significant, and any adverse determination could increase the Company's costs of doing business.

The Company's management does not anticipate at this time that disposition of those matters would be likely to have a material adverse effect on the Company.

## **9. Segment Information**

The Company reports net revenues from continuing operations and operating income from continuing operations by reportable segment. Reportable segments are components of the Company for which separate financial information is available that is evaluated on a regular basis by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

The Company provides similar merchandising and marketing services throughout the world, operating within two reportable segments, its Domestic Division and its International Division. The Company uses those divisions to improve its administration and operational and strategic focuses, and it tracks and reports certain financial information separately for each of those divisions. The Company measures the performance of its Domestic and International Divisions and subsidiaries using the same metrics. The primary measurement utilized by management is operating profits, historically the key indicator of long-term growth and profitability, as the Company is focused on reinvesting the operating profits of each of its international subsidiaries back into its local markets in an effort to improve market share and continued expansion efforts.



## SPAR Group, Inc. and Subsidiaries

## Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

Management evaluates performance as follows (in thousands):

|  | <b>Three Months<br/>Ended</b> |             | <b>Nine Months<br/>Ended</b>  |             |
|--|-------------------------------|-------------|-------------------------------|-------------|
|  | <b>September 30,<br/>2016</b> | <b>2015</b> | <b>September 30,<br/>2016</b> | <b>2015</b> |
| Revenue:                               |                               |             |                               |             |
| United States                          | <b>\$11,332</b>               | \$10,706    | <b>\$32,268</b>               | \$32,783    |
| International                          | <b>22,106</b>                 | 17,563      | <b>57,513</b>                 | 54,219      |
| Total revenue                          | <b>\$33,438</b>               | \$28,269    | <b>\$89,781</b>               | \$87,002    |
| Operating income (loss):               |                               |             |                               |             |
| United States                          | <b>\$(184)</b>                | ) \$63      | <b>\$(120)</b>                | ) \$309     |
| International                          | <b>614</b>                    | 166         | <b>1,496</b>                  | 784         |
| Total operating income                 | <b>\$430</b>                  | \$229       | <b>\$1,376</b>                | \$1,093     |
| Interest expense:                      |                               |             |                               |             |
| United States                          | <b>\$36</b>                   | \$25        | <b>\$88</b>                   | \$66        |
| International                          | <b>15</b>                     | 22          | <b>23</b>                     | 121         |
| Total interest expense                 | <b>\$51</b>                   | \$47        | <b>\$111</b>                  | \$187       |
| Other (income), net:                   |                               |             |                               |             |
| United States                          | <b>\$-</b>                    | <b>\$-</b>  | <b>\$-</b>                    | <b>\$-</b>  |
| International                          | <b>(78)</b>                   | ) (8        | <b>(183)</b>                  | ) (68       |
| Total other (income), net              | <b>\$(78)</b>                 | ) \$(8      | <b>\$(183)</b>                | ) \$(68     |
| Income before income tax expense:      |                               |             |                               |             |
| United States                          | <b>\$(220)</b>                | ) \$38      | <b>\$(208)</b>                | ) \$243     |
| International                          | <b>677</b>                    | 152         | <b>1,656</b>                  | 731         |
| Total income before income tax expense | <b>\$457</b>                  | \$190       | <b>\$1,448</b>                | \$974       |
| Income tax (benefit) expense:          |                               |             |                               |             |
| United States                          | <b>\$(306)</b>                | ) \$(66     | <b>\$(394)</b>                | ) \$(74     |
| International                          | <b>275</b>                    | 149         | <b>594</b>                    | 509         |
| Total income tax expense               | <b>\$(31)</b>                 | ) \$83      | <b>\$200</b>                  | \$435       |
| Net income:                            |                               |             |                               |             |

Edgar Filing: SPAR GROUP INC - Form 10-Q

|                                     |              |       |                |         |
|-------------------------------------|--------------|-------|----------------|---------|
| United States                       | <b>\$86</b>  | \$104 | <b>\$186</b>   | \$317   |
| International                       | <b>402</b>   | 3     | <b>1,062</b>   | 222     |
| Total net income                    | <b>\$488</b> | \$107 | <b>\$1,248</b> | \$539   |
| Depreciation and amortization:      |              |       |                |         |
| United States                       | <b>\$334</b> | \$344 | <b>\$1,014</b> | \$1,004 |
| International                       | <b>152</b>   | 127   | <b>445</b>     | 410     |
| Total depreciation and amortization | <b>\$486</b> | \$471 | <b>\$1,459</b> | \$1,414 |
| Capital expenditures:               |              |       |                |         |
| United States                       | <b>\$291</b> | \$213 | <b>\$798</b>   | \$918   |
| International                       | <b>151</b>   | 119   | <b>376</b>     | 320     |
| Total capital expenditures          | <b>\$442</b> | \$332 | <b>\$1,174</b> | \$1,238 |

Note: There were no inter-company sales for the nine months ended September 30, 2016 or 2015.

|               | <b>September<br/>30,<br/>2016</b> | <b>December<br/>31,<br/>2015</b> |
|---------------|-----------------------------------|----------------------------------|
| Assets:       |                                   |                                  |
| United States | <b>\$ 23,936</b>                  | \$ 21,799                        |
| International | <b>31,548</b>                     | 21,607                           |
| Total assets  | <b>\$ 55,484</b>                  | \$ 43,406                        |

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

**Geographic Data** (in thousands)

|                             | Three Months Ended September 30, |              |            |              | Nine Months Ended September 30, |              |            |              |   |
|-----------------------------|----------------------------------|--------------|------------|--------------|---------------------------------|--------------|------------|--------------|---|
|                             | 2016                             |              | 2015       |              | 2016                            |              | 2015       |              |   |
| International               |                                  | % of         |            | % of         |                                 | % of         |            | % of         |   |
| revenue:                    |                                  | consolidated |            | consolidated |                                 | consolidated |            | consolidated |   |
|                             |                                  | net          |            | net          |                                 | net          |            | net          |   |
|                             |                                  | revenue      |            | revenue      |                                 | revenue      |            | revenue      |   |
| South Africa                | \$5,936                          | 17.8         | % \$4,968  | 17.6         | % \$14,871                      | 16.6         | % \$15,189 | 17.5         | % |
| Mexico                      | 5,495                            | 16.4         | 3,962      | 14.0         | 15,600                          | 17.4         | 12,076     | 13.9         |   |
| China                       | 3,029                            | 9.1          | 3,682      | 13.0         | 8,646                           | 9.6          | 10,197     | 11.7         |   |
| Brazil                      | 1,850                            | 5.5          | –          | –            | 1,850                           | 2.1          | –          | –            |   |
| Japan                       | 1,799                            | 5.4          | 1,306      | 4.6          | 5,157                           | 5.7          | 3,907      | 4.5          |   |
| India                       | 1,523                            | 4.6          | 1,385      | 4.9          | 4,203                           | 4.7          | 5,001      | 5.7          |   |
| Canada                      | 1,453                            | 4.3          | 1,368      | 4.8          | 4,582                           | 5.1          | 4,173      | 4.8          |   |
| Australia                   | 945                              | 2.8          | 829        | 2.9          | 2,359                           | 2.6          | 3,316      | 3.8          |   |
| Turkey                      | 76                               | 0.2          | 63         | 0.2          | 245                             | 0.3          | 360        | 0.4          |   |
| Total international revenue | \$22,106                         | 66.1         | % \$17,563 | 62.0         | % \$57,513                      | 64.1         | % \$54,219 | 62.3         | % |

|                           | September 30, 2016 | December 31, 2015 |
|---------------------------|--------------------|-------------------|
| <u>Long lived assets:</u> |                    |                   |
| United States             | \$ 11,325          | \$ 10,147         |
| International             | 4,445              | 3,148             |
| Total long lived assets   | \$ 15,770          | \$ 13,295         |

**10. Purchase of Interests in Subsidiaries**

After acquiring SGRP Brasil Participações Ltda. ("SGRP Holdings"), a Brazilian limitada (which is a form of limited liability company), and establishing SPAR Brasil Serviços de Merchandising e Tecnologia S.A., a Brazilian

corporation ("SPAR BSMT"), in a series of related party transactions (See Note 5 to Condensed Consolidated Financial Statements - Related Party Transactions, above), SGRP Holdings and SPAR BSMT (the "Purchasers") entered into a Quota Purchase Agreement dated September 13, 2016 (the "NM QPA"), with Interservice Publicidade Sociedade Ltda., a Brazilian limitada, Momentum Promoções Ltda., a Brazilian limitada, and IPG Nederland B.V., a Netherlands company (collectively, the "Sellers"). The Sellers are subsidiaries of The Interpublic Group of Companies, Inc., a Delaware corporation ("Interpublic"), which is a global provider of advertising, media and other business services. The NM QPA provided for the acquisition by the Purchasers from the Sellers (the "NM Acquisition") of all of the equity shares (called "quotas") in New Momentum Ltda., a Brazilian limitada, and New Momentum Serviços Temporários Ltda., a Brazilian limitada (each a "NM Company" or collectively "the new Companies"), two of Interpublic's "In Store" companies in Brazil. SPAR BSMT acquired 99% of the quotas issued by each NM Company and SGRP Holdings acquired 1% of the quotas issued by each NM Company pursuant to the NM QPA. The closing of the acquisition of the NM Companies was completed with the disbursement of the purchase price to the Sellers on September 19, 2016, effective as of September 13, 2016.

The preliminary purchase price at closing for the NM Companies was R\$1,163,263 (approximately US\$358,000), based on a preliminary balance sheet as of July 31, 2016 which is subject to adjustment (upward or downward) based on the final closing balance sheet as of September 13, 2016. The Sellers have until December 12, 2016 to present the final closing balance sheet to the Company.

## SPAR Group, Inc. and Subsidiaries

## Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

Momentum Promoções Ltda., one of the Sellers, also agreed to provide certain transition services and continued use of certain existing office space to SPAR BSMT and each of the NM Companies (collectively, "SPAR Brazil"), pursuant to a Transition Services Agreement dated September 13, 2016 (the "Transition Agreement"), and a Sublease Agreement dated September 13, 2016 (the "Sublease"), respectively. The Sublease has an initial term of 12 months and requires monthly rent and back office support payments of R\$205,417 (approximately US\$65,700). The Transition Agreement has an initial term ending December 31, 2016, and requires various monthly service payments estimated to be in total R\$74,534 (approximately US\$23,850).

The Company has completed its preliminary calculation of the estimated fair value and related allocation of assets between goodwill and other. This valuation may be subject to change upon receipt of the final closing balance sheet as of September 13, 2016, which is expected by the end of this year at which time the Company will update its fair value allocation analysis. The Company expects to finalize the purchase price allocation as soon as practical, but no later than one year from acquisition date. A summary of assets acquired, goodwill and liabilities assumed and net of purchase price are as follows (in thousands):

|                                   |       |
|-----------------------------------|-------|
| Cash                              | \$52  |
| Net Working Capital, net of cash  | 222   |
| Fixed Assets                      | 23    |
| Non-operating Assets              | 11    |
| Goodwill                          | 457   |
| Assumed Liabilities               | (407) |
| Net Fair Value of Assets Acquired | \$358 |

The following table includes the amount of Brazil's revenue and earnings included in the Company's consolidated statement of income for the quarter ended September 30, 2016, and a pro forma calculation of the amounts that would have been included in the Company's consolidated statements of income for the three and nine month periods ended September 30, 2016 and 2015 had the Brazil acquisition date been January 1, 2015, instead of September 14, 2016 (in thousands):

|                                    | Revenue  | Net (Loss) |
|------------------------------------|----------|------------|
| Actual New Momentum Companies from | \$ 1,850 | \$ (43 )   |

Sept. 14 to Sept. 30,  
2016

|   |            |           |
|---|------------|-----------|
| Consolidated<br>supplemental pro<br>forma, July 1 to<br>September 30, 2016    | \$ 40,679  | \$ (151 ) |
| Consolidated<br>supplemental pro<br>forma, July 1 to<br>September 30, 2015    | \$ 35,301  | \$ (338 ) |
| Consolidated<br>supplemental pro<br>forma, January 1 to<br>September 30, 2016 | \$ 111,907 | \$ (161 ) |
| Consolidated<br>supplemental pro<br>forma, January 1 to<br>September 30, 2015 | \$ 111,209 | \$ (594 ) |

SPAR Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited) (continued)

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

**Forward-Looking Statements**

*This Quarterly Report on Form 10-Q for the nine months ended September 30, 2016 (this "Quarterly Report"), contains "forward-looking statements" made by SPAR Group, Inc. ("SGRP", and together with its subsidiaries, the "SPAR Group" or the "Company") and was filed on November 21, 2016, by SGRP with the Securities and Exchange Commission (the "SEC"). There also are "forward looking statements" contained in SGRP's Annual Report on Form 10-K for its fiscal year ended December 31, 2015 (as filed, the "Annual Report"), as filed with the SEC on March 30, 2016, in SGRP's definitive Proxy Statement respecting its Annual Meeting of Stockholders held on May 19, 2016 (as filed, the "Proxy Statement"), which SGRP filed with the SEC on April 27, 2016, and SGRP's Current Reports on Form 8-K and other reports and statements as and when filed with the SEC (including this Quarterly Report, the Annual Report and the Proxy Statement, each a "SEC Report"). "Forward-looking statements" are defined in 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 other applicable federal and state securities laws, rules and regulations, as amended (together with the Securities Act and Exchange Act, collectively, "Securities Laws").*

*The forward-looking statements made by the Company in this Quarterly Report may include (without limitation) any expectations, guidance or other information respecting the pursuit or achievement of the Company's five corporate objectives (growth, customer value, employee development, productivity & efficiency, and earnings per share), building upon the Company's strong foundation, leveraging compatible global opportunities, improving on the value we already deliver to customers, our growing client base, continuing balance sheet strength, customer contract expansion, growing revenues and becoming profitable through organic growth and acquisitions, attracting new business that will increase SPAR Group's revenues, improving product mix, continuing to maintain or reduce costs and consummating any transactions. The Company's forward-looking statements also include, in particular and without limitation, those made in the "Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources" in this Quarterly Report, and those made in "Business", "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Annual Report. 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 (and not place undue reliance on) the Company's forward-looking statements, risk factors and the other risks, cautions and information made, contained or noted in or incorporated by reference into this Quarterly Report, the Annual Report, the Proxy Statement and the other applicable SEC Reports that could cause the Company's actual performance or condition (including its assets, business, capital, cash flow, credit, expenses, financial condition, income, liabilities, liquidity, locations, marketing, operations, performance, prospects, sales, strategies, taxation or other achievement, results, risks, trends or condition to differ materially from the performance or condition planned, intended, anticipated, estimated or otherwise expected by the Company (collectively, "expectations") and described in the information in the Company's forward-looking and other statements, whether express or implied. Although the Company believes them to be reasonable, those expectations involve known and unknown risks, uncertainties and other unpredictable factors (many of which are beyond the Company's control) that could cause those expectations to fail to occur or be realized or such actual performance or condition to be materially and adversely different from the Company's expectations. In addition, 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. Accordingly, the Company cannot assure you that its expectations 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, any of which could be significant and materially adverse to the Company and the value of your investment in the Company's Common Stock.*

*You should carefully review the risk factors described in the Annual Report (See Item 1A – Risk Factors) and any other risks, cautions or information made, contained or noted in or incorporated by reference into this Quarterly Report, the Annual Report, the Proxy Statement or other applicable SEC Report. All forward-looking and other statements or information attributable to the Company or persons acting on its behalf are expressly subject to and qualified by all such risk factors and other risks, cautions and information.*



## **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 risks, cautions or information (in whole or in part), whether as a result of new information, risks or uncertainties, 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, independent, convenience, toy, home improvement and electronics stores. The Company also provides furniture and other product assembly services in stores, homes and offices. The Company has supplied these 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. The Company currently does business in 10 countries that encompass approximately 50% of the total world population through its operations in the United States, Canada, Japan, South Africa, India, China, Australia, Mexico, Turkey and Brazil.

Merchandising services primarily consist of regularly scheduled, special project and other product services provided at 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, demonstrating or promoting a product, providing on-site audit and in-store event staffing services and providing product 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.

### **An Overview of the Merchandising and Marketing Services Industry**

The merchandising and marketing services industry includes manufacturers, retailers, brokers, distributors and professional service merchandising companies. Merchandising services primarily involve placing orders, shelf

maintenance, display placement, reconfiguring products on store shelves and replenishing product inventory. Additional marketing services include but are not limited to new store sets and remodels, audits, sales assist, installation and assembly, product demos/sampling, promotion and various others. 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, have decreased their own store personnel and increased their reliance on manufacturers to perform such services. At one time, 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 manufacturers and retailers discovered that using their own sales representatives and employees for this purpose was expensive and inefficient. In addition, the changing retail environment, driven by the rise of digital and mobile technology, is fostering even more challenges to the labor model of retailers and manufacturers. These challenges include increased consumer demand for more interaction and engagement with retail sales associates, stores remodels to accommodate more technology, installation and continual maintenance of in-store digital and mobile technology, in-store pick-up and fulfillment of online orders and increased inventory management to reduce out-of-stocks from omnichannel shopping.

## **SPAR Group, Inc. and Subsidiaries**

Most 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 provide these services to retailers, manufacturers and other businesses around the world more effectively and efficiently than other available alternatives.

Another significant trend impacting the merchandising and marketing services business is the continued preference of consumers to shop in stores and their tendency 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 departments and 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 few years. Both retailers and manufacturers are seeking third party merchandisers to help them meet the increased demand for these labor-intensive services.

In addition, the consolidation of many retailers and changing store formats have 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 of those cases, stores are completely remodeled and re-merchandised to implement the new store formats.

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 global Internet and data network based technology (through computers or mobile devices) and its business model worldwide.

### ***The Company's Domestic and International Geographic Segments:***

The Company provides similar merchandising and marketing services throughout the world, operating within two reportable segments, its Domestic and International Divisions. The Company tracks and reports certain financial information separately for these two segments 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 local markets in an effort to improve its market share and continued expansion efforts. Certain financial information

regarding each of the Company's two segments, which includes their respective net revenues and operating income for each of the three and nine months ended September 30, 2016 and 2015, and their respective assets as of September 30, 2016, and December 31, 2015, is provided above in Note 9 to the Company's Condensed Consolidated Financial Statements – *Segment Information*.

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 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        | Date Established | SGRP Percentage Ownership | Principal Office Location                        |
|--------------------------|------------------|---------------------------|--|
| United States of America | 1979             | 100 %                     | White Plains, New York, United States of America |
| Japan                    | May 2001         | 100 %                     | Tokyo, Japan                                     |
| Canada                   | June 2003        | 100 %                     | Toronto, Canada                                  |
| South Africa             | April 2004       | 51 %                      | Durban, South Africa                             |
| India                    |                  |                           |  |