

SPAR GROUP INC  
Form 10-Q  
August 13, 2013

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

**Form 10-Q**

**(Mark One)**

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

OR

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

Commission file number: 0-27824

**SPAR Group, Inc.**

(Exact name of registrant as specified in its charter)

Delaware 33-0684451

State of Incorporation IRS Employer Identification No.

333 Westchester Avenue, South Building, Suite 204,

White Plains, New York 10604

(Address of principal executive offices, including zip code)

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

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

Yes No

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

Yes    No

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

Large Accelerated Filer  
Non-Accelerated Filer

Accelerated Filer  
Smaller Reporting Company

(Do not check if a smaller reporting company)

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

Yes    No

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

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**SPAR Group, Inc.**

Index

**PART I: FINANCIAL INFORMATION**

Item 1	Consolidated Financial Statements	
	Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012	2
	Consolidated Statements of Income and Comprehensive Income for the three and six months ended June 30, 2013 and 2012	3
	Consolidated Statement of Equity for the six months ended June 30, 2013	4
	Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012	5
	Notes to 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	30
Item 4	Controls and Procedures	31

**PART II: OTHER INFORMATION**

Item 1	Legal Proceedings	32
Item 1A	Risk Factors	32
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	32
Item 3	Defaults upon Senior Securities	33
Item 4	Submission of Matters to a Vote of Security Holders	33
Item 5	Other Information	33

Item 6	Exhibits	33
<b>SIGNATURES</b>		34

1

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

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

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

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

*See accompanying notes.*

## SPAR Group, Inc. and Subsidiaries

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

(unaudited)

*(In thousands, except per share data)*

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

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

*See accompanying notes.*

3

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

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

*See accompanying notes.*

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

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

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

*See accompanying notes.*

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

## **1. Basis of Presentation**

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

## **2. Business and Organization**

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

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

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

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

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

**3. Earnings Per Share**

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

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

**4. Credit Facilities**

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

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

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

	<b>June 30, 2013</b>	<b>December 31, 2012</b>
<u>Unused Availability:</u>		
United States	<b>\$2,515</b>	\$ 4,248
Australia	<b>1,098</b>	1,035
Canada	<b>713</b>	331
	<b>\$4,326</b>	<b>\$ 5,614</b>

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

**5. Capital Lease Obligations**

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

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

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

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



## 6. Related-Party Transactions

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

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

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

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

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

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

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

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

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

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

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

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

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

<b>Three Months Ended June</b>	<b>Six Months Ended June 30,</b>
------------------------------------	--------------------------------------

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

Accrued expenses due to affiliates :	<b>June</b>	December
	<b>30,</b>	31,
	<b>2013</b>	2012
Total accrued expenses due to affiliates	<b>\$1,318</b>	\$ 705

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

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

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

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

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

**7. Preferred Stock**

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

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

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

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

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

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

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

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



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

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

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

## 9. Customer Deposits

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

## 10. Commitments and Contingencies

### Legal Matters

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

## 11. Purchase of Interests in Subsidiaries

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

### BIP (Romania)

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

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

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

#### NMS (USA)

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

## SPAR Group, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

(unaudited) (continued)

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

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

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

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

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

CMR-Meridian (South Africa)

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

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

## SPAR Group, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

(unaudited) (continued)

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

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

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

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

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

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

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

Preceptor (India)

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

Certain MFI Assets (USA)

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

## SPAR Group, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

(unaudited) (continued)

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

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

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

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



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

## 12. Geographic Data

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

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

## SPAR Group, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

(unaudited) (continued)

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

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

June 30,      December 31,

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

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

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

## SPAR Group, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

(unaudited) (continued)

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

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

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

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

	<b>June 30,</b>	December 31,
	<b>2013</b>	2012
Accrued expenses and other current liabilities consist of the following:		
Accrued salaries payable	<b>\$804</b>	\$ 799
Taxes payable	<b>1,434</b>	1,460
Loans from domestic and international partners	<b>1,180</b>	1,559
Accrued accounting and legal expense	<b>487</b>	358
Final payment for purchase of NMS, LLC	-	200
Contingent liabilities, incentive for consulting fees	<b>689</b>	689
Short term portion of capital lease obligations	<b>130</b>	178
Other	<b>1,505</b>	1,486
Accrued expenses and other current liabilities	<b>\$6,229</b>	\$ 6,729

#### **14. Foreign Currency Rate Fluctuations**

The Company has foreign currency exposure with its international subsidiaries. In both 2013 and 2012, these exposures are primarily concentrated in the Australian Dollar, Canadian Dollar, Mexican Peso, South African Rand, Japanese Yen and Chinese Yuan. Total international assets were \$13.6 million and total liabilities were \$11.0 million based on exchange rates at June 30, 2013. International revenues for the six months ended June 30, 2013 and 2012 were \$33.8 million and \$25.2 million, respectively. The international division reported net losses of approximately \$130,000 and \$165,000 for the six months ended June 30, 2013 and 2012, respectively.

## SPAR Group, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

(unaudited) (continued)

## 15. Interest Rate Fluctuations

The Company is exposed to market risk related to the variable interest rate on its lines of credit, both in its United States subsidiaries (*i.e.*, the Domestic Merchandising Services Division) and in its International (non-U.S.) subsidiaries (*i.e.*, the International Merchandising Services Division). At June 30, 2013, the Company's outstanding lines of credit and other debt totaled approximately \$2.4 million, as noted in the table below (in thousands):

Location	Variable Interest Rate <sup>(1)</sup>	US Dollars <sup>(2)</sup>
United States	2.8%	\$ 2,269
International	0.1% - 9.1%	135
		\$ 2,404

(1)Based on interest rate at June 30, 2013.

(2)Based on exchange rate at June 30, 2013.

## 16. Taxes

In July 2006, the FASB issued an interpretation, *Accounting for Uncertainty in Income Taxes*, now codified as ASC Topic 740, which detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements. Tax positions must meet a more-likely-than-not recognition threshold and requires that interest and penalties that the tax law requires to be paid on the underpayment of taxes should be accrued on the difference between the amount claimed or expected to be claimed on the return and the tax benefit recognized in the financial statements. The Company's policy is to record this interest and penalties as additional tax expense. The Company's tax reserves at June 30, 2013, and December 31, 2012, totaled \$105,000 and \$93,000, respectively, for potential domestic state tax and federal tax liabilities.

SGRP and its subsidiaries file numerous consolidated, combined and separate company income tax returns in the U.S. Federal jurisdiction and in many U.S. state and foreign jurisdictions. With few exceptions, SGRP and its domestic subsidiaries are subject to U.S. Federal, state and local income tax examinations for the years 2009 through the present. However, tax authorities have the ability to review years prior to the position taken by the Company to the extent that SPAR Group utilized tax attributes carried forward from those prior years.

## 17. Subsequent Events

On July 10, 2013, SGRP entered into the Fourth Agreement of Amendment to Revolving Loan and Security Agreement And Other Documents (the "Fourth Amendment") with Sterling National Bank ("Sterling"), a copy of which was attached to SGRP's Current Report on Form 8-K as filed with the SEC on July 15, 2013. The Fourth Amendment amends, effective as of July 1, 2013, the Revolving Loan and Security Agreement effective July 6, 2010, as amended (as amended, the "Loan Agreement"), among SGRP and certain of its domestic subsidiaries as borrowers and Sterling as Agent and Lender.

The Fourth Amendment (among other things) extended the scheduled term of the Loan Agreement to July 6, 2016 (with no early termination fee), eliminated the requirement for a "closed lock box" so that collections no longer automatically pay down the loans under the Loan Agreement (giving SGRP more flexibility respecting its cash flow), and reduced the interest rate on those loans to the Agent's floating Prime Rate (as defined in the Loan Agreement) minus one half of one percent (1/2%) per annum (which is a reduction of 0.75 % per annum over the previous rate), and reduced the unused line fee to one-eighth of one percent (0.125%) per annum (which is half of the previous rate of one quarter of one percent (0.25%)).

In July 2013, SPAR BIP, the Company's subsidiary in Romania ("SPAR BIP") increased its capital structure and issued an additional 100 common stock shares to the Company, its local investor and the Company's affiliate, SPAR InfoTech, Inc. ("SIT") As a result, the Company's ownership in SPAR BIP decreased from 51% to 50.5%, SIT acquired 0.5% of SPAR BIP, and the Company's local investor continues to own 49% of the outstanding capital stock of SPAR BIP. The Company also provided an additional loan to SPAR BIP for needed working capital in the amount of \$150,000. The loan matures in 18 months and has an annual interest rate of 6%.

**SPAR Group, Inc. and Subsidiaries**

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

**Forward-Looking Statements**

*There are "forward-looking statements" contained in this Quarterly Report on Form 10-Q for the six months ended June 30, 2013 (this "Quarterly Report"), of SPAR Group, Inc. ("SGRP", and together with its subsidiaries, the "SPAR Group" or the "Company"), in SGRP's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the Securities and Exchange Commission (the "SEC") on April 2, 2013 (the "2012 Annual Report"), in SGRP's Proxy Statement for its 2013 Annual Meeting of Stockholders as filed with the SEC on April 19, 2013 (the "2013 Proxy Statement"), and the Company's other filings under applicable law with the SEC (including this Quarterly Report, the Company's 2012 Annual Report and the 2013 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"), 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 Company's forward-looking statements include, in particular and without limitation, the discussions in this Quarterly Report under the heading "Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources" and in the Company's 2012 Annual Report under the headings "Business", "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations". You can identify forward-looking statements in such information by the Company's use of terms such as "may", "will", "expect", "intend", "believe", "estimate", "anticipate", "continue" or similar words or variations or negatives of those words.*

*You should carefully consider all forward-looking statements, risk factors and the other risks, cautions and information noted in this Quarterly Report, the Company's 2012 Annual Report and the Company's other SEC Reports that could cause the Company's actual assets, business, capital, cash flow, credit, expenses, financial condition, income, liabilities, liquidity, locations, marketing, operations, prospects, sales, strategies, taxation or other achievement, results, risks or condition to differ materially from those anticipated by the Company and described in the information in the Company's forward-looking statements, whether express or implied, as the Company's anticipations are based upon the Company's plans, intentions, expectations and best estimates and (although the Company believe them to be reasonable) involve known and unknown risks, uncertainties and other factors that could cause them to fail to occur or be realized or to be materially and adversely different from those the Company anticipated.*

*Although the Company believes that its plans, intentions, expectations and estimates reflected or implied in such forward-looking statements are reasonable, the Company cannot assure you that such plans, intentions,*



*expectations or estimates will be achieved in whole or in part, that the Company has identified all potential risks, or that the Company can successfully avoid or mitigate such risks in whole or in part. You should carefully review the risk factors described in Item 1A – "Risk Factors" in the Company's 2012 Annual Report and any other risks, cautions or information contained in or incorporated by reference into any applicable SEC Report. All forward-looking and other statements and 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.*

*You should not place undue reliance on the Company's forward-looking statements and similar information because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond its control. The Company's forward-looking statements, risk factors and other risks, cautions and information (whether contained in this Quarterly Report or other applicable SEC Report) are based on the information currently available to the Company and speak only as of the date specifically referenced, or if no date is referenced, then as of December 31, 2012, in the case of the 2013 Proxy Statement or the last day of the period covered thereby in the case of other applicable SEC Report. New risks and uncertainties arise from time to time, and it is impossible for the Company to predict these matters or how they may arise or affect the Company. Over time, the Company's actual assets, business, capital, cash flow, credit, expenses, financial condition, income, liabilities, liquidity, locations, marketing, operations, prospects, sales, strategies, taxation or other achievements, results, risks or condition will likely differ from those expressed or implied by the Company's forward-looking statements, and such difference could be significant and materially adverse to the Company and the value of your investment in the Company's Common Stock.*

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

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

## **GENERAL**

SPAR Group, Inc. ("SGRP"), and its subsidiaries (together with SGRP, the "SPAR Group" or the "Company"), is a diversified international merchandising and marketing services company and provides a broad array of services worldwide to help companies improve their sales, operating efficiency and profits at retail locations. The Company provides its merchandising and other marketing services to manufacturers, distributors and retailers worldwide, primarily in mass merchandisers, office supply, grocery, drug, independent, convenience and electronics stores. The Company also provides furniture and other product assembly services in stores, homes and offices. The Company has supplied these project and product services in the United States since certain of its predecessors were formed in 1979 and internationally since the Company acquired its first international subsidiary in Japan in May of 2001. 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, Romania, China, Australia, Mexico and Turkey.

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, providing in-store audit service, and providing assembly services in stores, homes and offices. Other merchandising services include whole store or departmental product sets or resets, including new store openings, new product launches and in-store demonstrations, special seasonal or promotional merchandising, focused product support and product recalls. The Company continues to seek to expand its merchandising, assembly and marketing services business throughout the world.

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

According to industry estimates over two billion dollars are spent annually in the United States alone on retail merchandising and marketing services. The merchandising and marketing services industry includes manufacturers, retailers, food brokers and professional service merchandising companies. 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. These services primarily involve placing orders, shelf maintenance, display placement, reconfiguring products on store shelves and replenishing product inventory.

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. Initially, manufacturers attempted to satisfy the need for merchandising and marketing services in retail stores by utilizing their own sales representatives. Additionally, retailers also used their own employees to merchandise their stores to satisfy their own merchandising needs. However, both the manufacturers and the retailers discovered that using their own sales representatives and employees for this purpose was expensive and inefficient.

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 more effectively provide these services to retailers, manufacturers and other businesses around the world.

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

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

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

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

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

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

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

SPAR Group has provided merchandising and other marketing services in the United States since the formation of its predecessor in 1979 and outside the United States since it acquired its first international subsidiary in Japan in May of 2001. The Company currently conducts its business through its domestic and international divisions in 10 territories around the world (listed in the table below) that encompass approximately 50% of the total world population.

**SPAR Group, Inc. and Subsidiaries**

The Company's international business in each territory outside the United States is conducted through a foreign subsidiary incorporated in its primary territory. The primary territory 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:

	Date	SGRP Percentage	
Primary Territory	Established	Ownership	Principal Office Location
United States of America	1979	100%	White Plains, New York, United States of America <sup>6</sup>
Japan	May 2001	100%	Tokyo, Japan
Canada	June 2003	100%	Toronto, Canada
South Africa	April 2004	51% <sup>1</sup>	Durban, South Africa
India	April 2004	51% <sup>2</sup>	New Delhi, India
Australia	April 2006	51%	Melbourne, Australia
Romania	July 2009	51% <sup>3</sup>	Bucharest, Romania
China	March 2010	51% <sup>4</sup>	Shanghai, China
Mexico	August 2011	51%	Mexico City, Mexico
Turkey	August 2011	51% <sup>5</sup>	Istanbul, Turkey

In September 2012 the Company, through its subsidiary in South Africa (SGRP Meridian), entered into a joint venture agreement to expand its operations in South Africa. SGRP Meridian owns a 51% ownership interest in the new company; CMR Meridian (Pty) Ltd. ("CMR-Meridian").

In June 2011, the Company sold 49% of its interest in its Indian subsidiary to KROGNOS Integrated Marketing Services Private Limited. In March 2013, the company purchased a 51% interest in a new subsidiary in India, Preceptor Marketing Services Private Limited, which began operations in March 2013.

Currently the Company owns two subsidiaries in Romania. One subsidiary is 100% owned and is inactive, and the second subsidiary, acquired in May 2012, is 51% owned (see Note 17 to the Consolidated Financial Statements - *Subsequent events*, above). Also in May of 2012, the Company sold its 51% ownership in one of its other Romania subsidiaries, SPAR City S.R.L, to its original Local Investor.

Currently the Company owns two subsidiaries in China. One subsidiary is 100% owned and is inactive, and the second subsidiary, acquired in March 2010 and operational in August 2010, is 51% owned. In July 2011, the Company, through its active subsidiary in China (SPAR Shanghai), entered into a joint venture agreement to expand its operations in China. SPAR Shanghai has a 51% ownership interest in the new company; SPAR DSI Human Resource Company.

In August 2011, the Company sold its 51% ownership in its original subsidiary in Turkey to its original Local Investor, and in November 2011 the Company started a new 51% owned subsidiary to compete in this important market.

In September 2012, the Company established a new subsidiary, National Merchandising Services, LLC, ("NMS") 51% owned by the Company, with its principal office in Georgia. In March 2013, the Company purchased general

merchandising service and certain in-store audit service businesses from Market Force Information, Inc. (“MFI”).

For more information respecting the Company's business and operations, please see Item 1 - *Business and Organization* in the Company's 2012 Annual Report.

The Company operates in the same single business segment (e.g., merchandising and marketing services) in both its domestic and international divisions (as described above), and the Company tracks and reports certain financial information separately for its subsidiaries in each of those divisions using the same metrics. The primary measurement utilized by management is operating profit level, historically the key indicator of long-term growth and profitability, as the Company is focused on reinvesting the operating profits of each of its international subsidiaries back into its local markets in an effort to improve its market share and continued expansion efforts. Certain financial information regarding each of the Company's two geographic divisions, which includes their respective net revenues and operating income (loss) for each of the three month and six month periods ended June 30, 2013, and June 30, 2012, and their respective long-lived assets at June 30, 2013, and December 31, 2012, are provided in Note 12 to the Consolidated Financial Statements – *Geographic Data*, above. See also Item I - *The Company's Business Strategies (including Leveraging and Improving on the Company's Technological Strength and Acquisition Strategies and Strategic Acquisitions)*, *Descriptions of the Company's Services*, *The Company's Sales and Marketing*, *The Company's Customer Base* and *The Company's Competition*, all in the Company's 2012 Annual Statement.

**SPAR Group, Inc. and Subsidiaries****CRITICAL ACCOUNTING POLICIES**

There were no material changes during the six months ended June 30, 2013, to the Company's critical accounting policies as reported in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the SEC on April 2, 2013.

**Results of Operations****Three months ended June 30, 2013, compared to three months ended June 30, 2012**

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

	<b>Three Months Ended June 30,</b>			
	<b>2013</b>		<b>2012</b>	
	<b>\$</b>	<b>%</b>	<b>\$</b>	<b>%</b>
Net revenues	<b>\$28,696</b>	100.0%	<b>\$24,343</b>	100.0%
Cost of revenues	<b>21,883</b>	76.3	<b>17,635</b>	72.4
Selling, general & administrative expense	<b>6,135</b>	21.4	<b>5,634</b>	23.1
Depreciation & amortization	<b>409</b>	1.4	<b>293</b>	1.2
Interest expense	<b>20</b>	0.1	<b>12</b>	0.1
Other (income) expense	<b>(60 )</b>	(0.2 )	<b>75</b>	0.3
Income before income taxes	<b>309</b>	1.0	<b>694</b>	2.9
Provision for income taxes	<b>250</b>	0.8	<b>58</b>	0.2
Net income	<b>59</b>	0.2	<b>636</b>	2.7
Net (income) loss attributable to non-controlling interest	<b>(189 )</b>	(0.7 )	<b>82</b>	0.3
Net (loss) income attributable to Spar Group, Inc.	<b>\$(130 )</b>	(0.5 )%	<b>\$718</b>	3.0 %

**Net Revenues**

Net revenues for the three months ended June 30, 2013, were \$28.7 million, compared to \$24.3 million for the three months ended June 30, 2012, an increase of \$4.4 million or 18%.



Domestic net revenues totaled \$11.4 million in the three months ended June 30, 2013, compared to \$10.9 million for the same period in 2012. Domestic net revenues increased by approximately \$500,000. The increase was primarily due to incremental revenue from the recent acquisition of general merchandising and certain in-store audit services from Market Force Information (“MFI”) and the September 2012 acquisition of National Merchandising Services, LLC. The incremental revenue was offset by a decrease syndicated services and other project work.

International net revenues totaled \$17.3 million for the three months ended June 30, 2013, compared to \$13.5 million for the same period in 2012, an increase of \$3.8 million or 29%. The increase in 2013 international net revenues was primarily due to incremental revenue from the newly integrated acquisitions in South Africa and India and increased revenue in China, Mexico and Australia.

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

### **Cost of Revenues**

The Company's cost of revenues consists of its on-site labor and field administration fees, travel and other direct labor-related expenses and was 76.3% of its net revenues for the three months ended June 30, 2013, and 72.4% of its net revenues for the three months ended June 30, 2012.

Domestic cost of revenues was 70.0% of net revenues for the three months ended June 30, 2013, and 65.6% of net revenues for the three months ended June 30, 2012. The increase in cost of revenues as a percentage of net revenues was 4.4% due primarily to an unfavorable mix of syndicated and project work compared to last year. Approximately 84% and 90% of the Company's domestic cost of revenues in the three months ended June 30, 2013 and 2012, respectively, resulted from in-store merchandiser specialist, on-site assembly technician and field administration services purchased from certain of the Company's affiliates, SPAR Marketing Services, Inc. ("SMS"), and SPAR Management Services, Inc. ("SMSI"), respectively (See - Note 6 to the Consolidated Financial Statements - *Related-Party Transactions*, above).

Internationally, the cost of revenues increased to 80.4% of net revenues for the three months ended June 30, 2013, compared to 78% of net revenues for the three months ended June 30, 2012. The cost of revenue percentage increase of 2.4% was primarily due to higher cost margin business in the new markets in Turkey, India, and Romania and the mix of business in Japan and China.

### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses of the Company include its corporate overhead, project management, information technology, executive compensation, human resources, legal and accounting expenses. Selling, general and administrative expenses were approximately \$6.1 million and \$5.6 million for the three months ended June 30, 2013 and 2012, respectively.

Domestic selling, general and administrative expenses totaled \$3.1 million for three months ended June 30, 2013, compared to \$2.5 million for the three months ended June 30, 2012. The increase of \$600,000 was primarily due to the MFI acquisition.

International selling, general and administrative expenses totaled \$3.0 million for the three months ended June 30, 2013, compared to \$3.1 million for the same period in 2012. The decrease of approximately \$100,000 was primarily attributable to reduced costs in Japan.

### **Depreciation and Amortization**

Depreciation and amortization charges totaled \$409,000 for the three months ended June 30, 2013, and \$293,000 for the same period in 2012. The increase of \$116,000 is primarily attributable to amortization related to intangible assets recorded in valuing recent acquisitions of MFI, NMS LLC and CMR.

### **Interest Expense**

The Company's net interest expense was \$20,000 and \$12,000 for the three months ended June 30, 2013 and 2012, respectively. The increase of \$8,000 is primarily attributable to Mexico subsidiary.

### **Other (Income) Expense**

Other income totaled \$60,000 for the three months ended June 30, 2013 and other expense was \$75,000 for the same period in 2012.

### **Income Taxes**

The income tax provision totaled \$250,000 and \$58,000 for the three months ended June 30, 2013 and 2012, respectively. The tax provision resulted primarily from domestic state taxes and for tax provisions related to certain international profits. The Company recognizes minimum federal tax provisions as the Company anticipates utilizing operating loss carry forwards in 2013.

**SPAR Group, Inc. and Subsidiaries****Non-controlling Interest**

Net operating profits from the non-controlling interest, from the Company's 51% owned subsidiaries, resulted in a reduction of net income of \$189,000 for the three months ended June 30, 2013, compared to an increase of net income of \$82,000 for the three months ended June 30, 2012.

**Net Income**

The Company reported a net loss of \$130,000 for the three months ended June 30, 2013, or \$0.01 per diluted share, compared to a net income of \$718,000, or \$0.04 per diluted share, for the corresponding period last year.

**Six months ended June 30, 2013, compared to six months ended June 30, 2012**

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

	<b>Six Months Ended June 30,</b>			
	<b>2013</b>		<b>2012</b>	
	<b>\$</b>	<b>%</b>	<b>\$</b>	<b>%</b>
Net revenues	<b>\$54,873</b>	100.0%	<b>\$45,390</b>	100.0%
Cost of revenues	<b>42,028</b>	76.6	<b>32,913</b>	72.5
Selling, general & administrative expense	<b>11,507</b>	21.0	<b>10,655</b>	23.5
Depreciation & amortization	<b>711</b>	1.3	<b>570</b>	1.3
Interest expense	<b>51</b>	0.1	<b>63</b>	0.1
Other income	<b>(73 )</b>	(0.1 )	<b>(7 )</b>	-
Income before income taxes	<b>649</b>	1.1	<b>1,196</b>	2.6
Provision for income taxes	<b>378</b>	0.6	<b>101</b>	0.2
Net income	<b>271</b>	0.5	<b>1,095</b>	2.4
Net income attributable to non-controlling interest	<b>(358 )</b>	(0.7 )	<b>(70 )</b>	(0.2 )
Net (loss) income attributable to Spar Group, Inc.	<b>\$(87 )</b>	(0.2 )%	<b>\$1,025</b>	2.2 %

## Net Revenues

Net revenues for the six months ended June 30, 2013, were \$54.9 million, compared to \$45.4 million for the six months ended June 30, 2012, an increase of \$9.5 million or 21%.

Domestic net revenues totaled \$21.1 million in the six months ended June 30, 2013, compared to \$20.2 million for the same period in 2012. Domestic net revenues increased by approximately \$900,000. The increase was primarily due to incremental revenue from the recent acquisition of general merchandising and certain in-store audit services from Market Force Information (“MFI”) and the September 2012 acquisition of National Merchandising Services, LLC. The incremental revenue was offset by a decrease syndicated services and other project work.

International net revenues totaled \$33.8 million for the six months ended June 30, 2013, compared to \$25.2 million for the same period in 2012, an increase of \$8.6 million or 34%. The increase in 2013 international net revenues was primarily due to incremental revenue from the newly integrated acquisitions in South Africa and Romania and increased revenue in China, Mexico and Australia.

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

### **Cost of Revenues**

The Company's cost of revenues consists of its on-site labor and administration fees, travel and other direct labor-related expenses and was 76.6% of its net revenues for the six months ended June 30, 2013, and 72.5% of its net revenues for the six months ended June 30, 2012.

Domestic cost of revenues was 69.3% of net revenues for the six months ended June 30, 2013, and 66.8% of net revenues for the six months ended June 30, 2012. The increase in cost of revenues as a percentage of net revenues was 2.5% due primarily to an unfavorable mix of syndicated and project work compared to last year. Approximately 85% and 91% of the Company's domestic cost of revenues in the six months ended June 30, 2013 and 2012, respectively, resulted from in-store merchandiser specialist on-site assembly technician and field administration services purchased from certain of the Company's affiliates, SPAR Marketing Services, Inc. ("SMS"), and SPAR Management Services, Inc. ("SMSI"), respectively (See - Note 6 to the Consolidated Financial Statements- *Related-Party Transactions*, above).

Internationally, the cost of revenues increased to 81.1% of net revenues for the six months ended June 30, 2013, compared to 77.1% of net revenues for the six months ended June 30, 2012. The cost of revenue percentage increase of 4.0% was primarily due to higher cost margin business in the new markets in Turkey, Mexico, and Romania and the mix of business in Japan, Canada and China.

### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses of the Company include its corporate overhead, project management, information technology, executive compensation, human resources, legal and accounting expenses. Selling, general and administrative expenses were approximately \$11.5 million and \$10.7 million for the six months ended June 30, 2013 and 2012, respectively.

Domestic selling, general and administrative expenses totaled \$5.6 million for six months ended June 30, 2013, compared to \$4.9 million for the six months ended June 30, 2012. The increase of \$700,000 was primarily due to the MFI acquisition.

International selling, general and administrative expenses totaled \$5.9 million and \$5.8 million for the six months ended June 30, 2013 and 2012, respectively.

### **Depreciation and Amortization**

Depreciation and amortization charges totaled \$711,000 for the six months ended June 30, 2013, and \$570,000 for the same period in 2012. The increase is primarily attributable to amortization related to intangible assets recorded in valuing recent acquisitions of MFI, NMS LLC and CMR.

### **Interest Expense**

The Company's net interest expense was \$51,000 and \$63,000 for the six months ended June 30, 2013 and 2012, respectively. The decrease in interest expense is directly attributable to reduced borrowings as well as lower interest rates.

### **Other Income**

Other income totaled \$73,000 for the six months ended June 30, 2013 and \$7,000 for the same period in 2012.

### **Income Taxes**

The income tax provision totaled \$378,000 and \$101,000 for the six months ended June 30, 2013 and 2012, respectively. The tax provision resulted primarily from domestic state taxes and for tax provisions related to certain international profits. The Company recognizes minimum federal tax provisions as the Company anticipates utilizing operating loss carry forwards in 2013.

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

### **Non-controlling Interest**

Net operating profits from the non-controlling interest, from the Company's 51% owned subsidiaries, resulted in a reduction of net income of \$358,000 for the six months ended June 30, 2013, compared to a reduction of net income of \$70,000 for the six months ended June 30, 2012.

### **Net Income**

The Company reported a net loss of \$87,000 for the six months ended June 30, 2013, or \$0.00 per diluted share, compared to a net income of \$1 million, or \$0.05 per diluted share, for the corresponding period last year.

### **Liquidity and Capital Resources**

In the six months ended June 30, 2013, the Company had net income before non-controlling interest of \$271,000.

Net cash provided by operating activities was \$4.4 million and \$3.2 million for the six months ended June 30, 2013 and 2012, respectively. The net cash provided by operating activities was primarily due to a decrease in accounts receivable and increases in accounts payable and accrued expenses.

Net cash used in investing activities for the six months ended June 30, 2013, and June 30, 2012, was approximately \$2.3 million and \$448,000, respectively. The net cash used in investing activities was primarily a result of the purchase of the MFI business, plus fixed asset additions.

Net cash used in financing activities for the six months ended June 30, 2013, and June 30, 2012, was approximately \$313,000 and \$2.5 million, respectively. Net cash used in financing activities was primarily a result of payments on lines of credit, and payments on the capital leases.



The above activity resulted in an increase in cash and cash equivalents for the six months ended June 30, 2013, of \$1.3 million.

At June 30, 2013, the Company had net working capital of \$8.3 million, as compared to net working capital of \$9.7 million at December 31, 2012. The Company's current ratio was 1.5 and 1.7 at June 30, 2013, and December 31, 2012, respectively.

**Domestic Credit Facility:**

SGRP and certain of its domestic subsidiaries, namely SPAR Marketing Force, Inc., National Assembly Services, Inc., SPAR Group International, Inc., SPAR Trademarks, Inc., and SPAR Acquisition, Inc. (each a "Subsidiary Borrower", and together with SGRP, collectively, the "Borrowers"), are parties to a Revolving Loan and Security Agreement dated as of July 6, 2010, as amended in June 2011, July 2012 and January 2013 (as amended, the "Loan Agreement"), with Sterling National Bank as "Lenders" and "Agent" (the "Sterling Credit Facility"). Effective January 1, 2013, the Sterling Credit Facility charged interest on the loans outstanding thereunder at the Prime Rate (as that term is defined in the Loan Agreement) plus one quarter of one percent (1/4%) per annum (instead of the higher rates previously charged), which interest rate automatically changes with each change in such Prime Rate.

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

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

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

The Sterling Credit Facility contains certain financial and other restrictive covenants and also limits certain expenditures by the Borrowers, including, but not limited to, capital expenditures and other investments.

The parties have amended the Sterling Loan Agreement effective as of July 1, 2013, to (among other things) extended the scheduled term of the Loan Agreement to July 6, 2016 (with no early termination fee), eliminated the requirement for a "closed lock box" so that collections no longer automatically pay down the loans under the Loan Agreement, and reduced the interest rate on those loans to the Agent's floating Prime Rate (as defined in the Loan Agreement) minus one half of one percent (1/2%) per annum (which is a reduction of 0.75 % per annum over the previous rate), and reduced the unused line fee to one-eighth of one percent (0.125%) per annum (which is half of the previous rate of one quarter of one percent (0.25%)). See Note 17 to Consolidated Financial Statements -- *Subsequent Events*, above.

### **International Credit Facilities:**

In October 2011, SPARFACTS Australia Pty. Ltd. replaced the Commonwealth Bank line of credit with a new receivables based secured line of credit facility with Oxford Funding Pty Ltd. for \$1.2 million (Australian) or approximately \$1.1 million (based upon the exchange rate at June 30, 2013). 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 technically expired on October 31, 2012, but is being extended from month to month at the Company's request. SPARFACTS is in the process of negotiating new financing.

SPAR Canada Company, a wholly owned subsidiary, has a secured credit agreement with Royal Bank of Canada providing for a Demand Operating Loan for a maximum borrowing of \$750,000 (Canadian) or approximately \$713,000 (based upon the exchange rate at June 30, 2013). The Demand Operating Loan provides for borrowing based upon a formula as defined in the agreement (principally 75% of eligible accounts receivable less certain deductions) and a minimum total debt to tangible net worth covenant.

The Japanese subsidiary, SPAR FM Japan, Inc., a wholly owned subsidiary, has secured a loan with Mizuho Bank in the amount of 20.0 million Yen (Japanese), or approximately \$202,000. The loan is payable in monthly installments of 238,000 Yen or \$2,400 at an interest rate of 0.1% per annum with a maturity date of February 28, 2018. The

outstanding balance at June 30, 2013, was approximately 13.3 million Yen or \$135,000 (based upon the exchange rate at June 30, 2013).

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

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

**SPAR Group, Inc. and Subsidiaries**

	<b>June 30, 2013</b>	December 31, 2012
<u>Unused Availability:</u>		
United States	<b>\$2,515</b>	\$ 4,248
Australia	<b>1,098</b>	1,035
Canada	<b>713</b>	331
	<b>\$4,326</b>	\$ 5,614

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.

**Certain Contractual Obligations**

The following table contains a summary of certain of the Company's contractual obligations by category as of June 30, 2013 (in thousands):

<b>Contractual Obligations</b>	<b>Period in which payments are due</b>				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Credit Facilities	\$ 2,404	\$ 2,298	\$ 58	\$ 48	\$ –
Capital Lease Obligations	192	135	57	–	–
Contingent Liabilities	689	242	447	–	–
Operating Lease Obligations	3,708	1,070	1,419	895	324
Total	\$ 6,993	\$ 3,745	\$ 1,981	\$ 943	\$ 324

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

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

The Company is exposed to market risk related to the variable interest rate on its lines of credit, both in its United States subsidiaries (*i.e.*, the Domestic Merchandising Services Division) and in its International (non-U.S.) subsidiaries (*i.e.*, the International Merchandising Services Division). At June 30, 2013, the Company's outstanding lines of credit and other debt totaled approximately \$2.4 million, as noted in the table below (in thousands):

Location	Variable Interest Rate <sup>(1)</sup>	US Dollars <sup>(2)</sup>
United States	2.8%	\$ 2,269
International	0.1% - 9.1%	135
		\$ 2,404

(1) Based on interest rate at June 30, 2013.

(2) Based on exchange rate at June 30, 2013.

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

The Company has foreign currency exposure with its international subsidiaries. In both 2013 and 2012, these exposures are primarily concentrated in the Australian Dollar, Canadian Dollar, Mexican Peso, South African Rand, Japanese Yen and Chinese Yuan. Total international assets were \$13.6 million and total liabilities were \$11 million based on exchange rates at June 30, 2013. International revenues for the six months ended June 30, 2013 and 2012 were \$33.8 million and \$25.2 million, respectively. The international division reported net losses of approximately \$130,000 and \$165,000 for the six months ended June 30, 2013 and 2012, respectively.

## **Item 4. Controls and Procedures**

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

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

The Company's management has evaluated the effectiveness of the Company's internal control over financial reporting using the "Internal Control – Integrated Framework (1992)" created by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework. Based on this evaluation, management has concluded that internal controls over financial reporting were effective as of June 30, 2013.

### **Management's Evaluation of Disclosure Controls and Procedures**

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

disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

### **Changes in Internal Controls Over Financial Reporting**

There have been no changes in the Company's internal controls over financial reporting that occurred during the Company's second quarter of its 2013 fiscal year that materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

**SPAR Group, Inc. and Subsidiaries**

**PART II: OTHER INFORMATION**

**Item 1. Legal Proceedings**

The Company is a party to various legal actions and administrative proceedings arising in the normal course of business. In addition, the Company is involved in various other legal actions and administrative proceedings through its contractual obligation to pay SMS's costs (as part of the total costs of SMS borne by the Company - see Note 6 to Consolidated Financial Statements - *Related Party Transactions*, above). In the opinion of the Company's management, disposition of these matters are not anticipated to have a material adverse effect on the Company or its estimated or desired assets, business, capital, cash flow, credit, expenses, financial condition, income, liabilities, liquidity, locations, marketing, operations, prospects, sales, strategies, taxation or other achievement, results or condition.

**Item 1A. Risk Factors**

*Existing Risk Factors*

Various risk factors applicable to the Company and its businesses are described in Item 1A under the caption "Risk Factors" in SGRP's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the Securities and Exchange Commission (the "SEC") on April 2, 2013 (the "2012 Annual Report"), which risk factors are incorporated by reference into this Quarterly Report. There have been no material changes in the Company's risk factors since those reports.

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

Item 2(a): Not applicable

Item 2(b): Not applicable



Item 2(c):

The following table summarizes the repurchases by SGRP and its "affiliated purchasers" (as defined in SEC Rule §240.10b-18(a)(3)) of its common stock during the quarter and three month period that ended on June 30, 2013:

**Issuer Purchases of Equity Securities**

<b>Period</b>	<b>(a) Total number of shares purchased</b>	<b>(b) Average price paid per share</b>	<b>(c) Total number of shares purchased as part of SGRP's publicly announced repurchase plans or programs</b>	<b>(d) Maximum number of shares that may yet be purchased</b>
Balance March 31, 2013	-	-	-	482,311
April 2013	-	-	-	482,311
May 2013	14,802	\$ 1.96	14,802	467,509
June 2013	27,774	\$ 2.04	27,774	439,735
Total Quarter	42,576	\$ 2.01	42,576	439,735

There were no such affiliated purchasers during that period.

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

The repurchases described above were made pursuant to the SPAR Group, Inc., 2012 Stock Repurchase Program (the "Repurchase Program"), as approved by SGRP's Audit Committee and adopted by its Board of Directors on August 8, 2012, and ratified on November 8, 2012. Under the Repurchase Program, SGRP may repurchase shares of its common stock through August 8, 2015, but not more than 500,000 shares in total, and those repurchases would be made from time to time in the open market and through privately-negotiated transactions, subject to general market and other conditions. SGRP does not intend to repurchase any shares in the market during any blackout period in violation of the rules applicable to its officers and directors under the SPAR Group, Inc. Statement of Policy Regarding Personal Securities Transactions in SGRP Stock and Non-Public Information As Adopted, Restated, Effective and Dated as of May 1, 2004, and As Further Amended Through March 10, 2011 (other than purchases that would otherwise be permitted under the circumstances for anyone covered by such policy). The Company anticipates continuing its Repurchase Program throughout 2013.

### **Item 3. Defaults upon Senior Securities**

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

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

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

Not applicable.

### **Item 5. Other Information**

Not applicable.

### **Item 6. Exhibits**

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- 31.1 Certification of the CEO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as filed herewith.
- 31.2 Certification of the CFO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as filed herewith.
- 32.1 Certification of the CEO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as filed herewith.
- 32.2 Certification of the CFO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as filed herewith.
- 101.INS\* XBRL Instance
- 101.SCH\* XBRL Taxonomy Extension Schema
- 101.CAL\* XBRL Taxonomy Extension Calculation
- 101.DEF\* XBRL Taxonomy Extension Definition
- 101.LAB\* XBRL Taxonomy Extension Labels
- 101.PRE\* XBRL Taxonomy Extension Presentation

\* XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

**SPAR Group, Inc. and Subsidiaries**

**SIGNATURES**

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

Date: August 13, 2013    SPAR Group, Inc., Registrant

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