

SPAR GROUP INC  
Form 10-Q  
August 14, 2008

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, 2008**.

OR

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

Commission file number: 0-27824

**SPAR Group, Inc.**

(Exact name of registrant as specified in its charter)

Delaware  
State of Incorporation

33-0684451  
IRS Employer Identification No.

560 White Plains Road, Suite 210, Tarrytown, New York 10591  
(Address of principal executive offices, including zip code)

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

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

Yes  No

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

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

YES  NO

On June 30, 2008 there were 19,136,865 shares of Common Stock outstanding.

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**SPAR Group, Inc.**

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**PART I: FINANCIAL INFORMATION****Item 1. Financial Statements****SPAR Group, Inc.**

## Consolidated Balance Sheets

(In thousands, except share and per share data)

|  | <b>June 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|--|--------------------------|------------------------------|
|  | (Unaudited)              | (Note)                       |
| <b>Assets</b>                                  |                          |                              |
| Current assets:                                |                          |                              |
| Cash and cash equivalents                      | \$ 2,245                 | \$ 1,246                     |
| Accounts receivable, net                       | 13,521                   | 13,748                       |
| Prepaid expenses and other current assets      | 929                      | 975                          |
| Total current assets                           | <b>16,695</b>            | 15,969                       |
| Property and equipment, net                    | 1,532                    | 1,528                        |
| Goodwill                                       | 798                      | 798                          |
| Other assets                                   | 1,724                    | 1,648                        |
| Total assets                                   | <b>\$ 20,749</b>         | \$ 19,943                    |
| <b>Liabilities and stockholders' equity</b>    |                          |                              |
| Current liabilities:                           |                          |                              |
| Accounts payable                               | \$ 4,439                 | \$ 3,631                     |
| Accrued expenses and other current liabilities | 4,597                    | 3,981                        |
| Accrued expenses due to affiliates             | 2,343                    | 2,107                        |
| Customer deposits                              | 651                      | 580                          |
| Lines of credit                                | 5,129                    | 6,119                        |
| Total current liabilities                      | <b>17,159</b>            | 16,418                       |
| Other long-term liabilities                    | 231                      | 299                          |
| Minority interest                              | 832                      | 676                          |
| Total liabilities                              | <b>18,222</b>            | 17,393                       |
| Commitments and contingencies (Note – 9)       |                          |                              |
| Stockholders' equity:                          |                          |                              |
| Preferred stock, \$.01 par value:              |                          |                              |
| Authorized shares – 3,000,000                  |                          |                              |
| Issued and outstanding shares –                |                          |                              |
| 89,286 – March 31, 2008                        | 1                        | —                            |
| Common stock, \$.01 par value:                 |                          |                              |
| Authorized shares – 47,000,000                 |                          |                              |
| Issued and outstanding shares –                |                          |                              |
| 19,136,865 – June 30, 2008                     | 191                      | 191                          |

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19,089,177 – December 31, 2007

|  |           |           |
|--|-----------|-----------|
| Treasury stock                             | (1 )      | (1 )      |
| Accumulated other comprehensive loss       | (69 )     | (43 )     |
| Additional paid-in capital                 | 12,231    | 11,982    |
| Accumulated deficit                        | (9,826 )  | (9,579 )  |
| Total stockholders' equity                 | 2,527     | 2,550     |
| Total liabilities and stockholders' equity | \$ 20,749 | \$ 19,943 |

Note: The Balance Sheet at December 31, 2007, is an excerpt from the audited financial statements at that date but does not include certain information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. See accompanying notes.

**SPAR Group, Inc.**

## Consolidated Statements of Operations

(unaudited)

(In thousands, except per share data)

|  | Three Months Ended June 30, |             | Six Months Ended June 30, |             |
|--|-----------------------------|-------------|---------------------------|-------------|
|  | 2008                        | 2007        | 2008                      | 2007        |
| Net revenues   | \$ 18,910                   | \$ 12,506   | \$36,364                  | \$ 27,919   |
| Cost of revenues   | 13,719                      | 8,757       | 26,203                    | 19,255      |
| Gross profit   | 5,191                       | 3,749       | 10,161                    | 8,664       |
| Selling, general and administrative expenses                           | 4,510                       | 5,137       | 9,168                     | 10,144      |
| Depreciation and amortization  | 221                         | 194         | 429                       | 391         |
| Operating income (loss)  | 460                         | (1,582 )    | 564                       | (1,871 )    |
| Interest expense   | 81                          | 93          | 162                       | 181         |
| Other expense  | 521                         | 18          | 564                       | 38          |
| Loss before provision for income taxes (benefit) and minority interest | (142 )                      | (1,693 )    | (162 )                    | (2,090 )    |
| Provision for income taxes (benefit)                                   | (185 )                      | 74          | (21 )                     | 141         |
| Income (loss) before minority interest                                 | 43                          | (1,767 )    | (141 )                    | (2,231 )    |
| Minority interest  | 40                          | (28 )       | 106                       | 16          |
| Net income (loss)  | \$ 3                        | \$ (1,739 ) | \$ (247 )                 | \$ (2,247 ) |
| Basic/diluted net loss per common share:                               |                             |             |                           |             |
| Net loss – basic/diluted   | \$ —                        | \$ (0.09 )  | \$ (0.01 )                | \$ (0.12 )  |
| Weighted average common shares – basic/diluted                         | 19,133                      | 18,934      | 19,123                    | 18,934      |

*See accompanying notes*



**SPAR Group, Inc.**

## Consolidated Statements of Cash Flows

(unaudited)(In thousands)

|  | <b>Six Months Ended June 30,</b> |             |
|--|----------------------------------|-------------|
|  | <b>2008</b>                      | <b>2007</b> |
| <b>Operating activities</b>                                      |                                  |             |
| Net cash provided by operating activities                        | \$ 2,274                         | \$ 3,758    |
| <b>Investing activities</b>                                      |                                  |             |
| Purchases of property and equipment                              | (225 )                           | (429 )      |
| <b>Financing activities</b>                                      |                                  |             |
| Net payments on lines of credit                                  | (990 )                           | (2,892 )    |
| Other long-term liabilities                                      | (68 )                            | (46 )       |
| Proceeds from employee stock purchase plan and options exercised | 34                               | —           |
| Net cash used in financing activities                            | (1,024 )                         | (2,938 )    |
| Translation (loss)/gain  | (26 )                            | 62          |
| Net change in cash and cash equivalents                          | 999                              | 453         |
| Cash and cash equivalents at beginning of period                 | 1,246                            | 1,148       |
| Cash and cash equivalents at end of period                       | \$ 2,245                         | \$ 1,601    |
| <b>Supplemental disclosure of cash flows information</b>         |                                  |             |
| Interest paid  | \$ 147                           | \$ 127      |
| Taxes paid   | \$ 9                             | \$ 8        |

The Company acquired equipment by entering into capital leases in the amount of \$358,000 in the first quarter of 2007.

The Company issued preferred stock in the first quarter of 2008. Upon issuance of the preferred shares the accrued expenses due to affiliates was reduced by \$100,000.

*See accompanying notes.*



**SPAR Group, Inc.**

**Notes to Consolidated Financial Statements**

(unaudited)

**1. Basis of Presentation**

The accompanying unaudited, consolidated financial statements of SPAR Group, Inc., a Delaware corporation (“SGRP”), and its subsidiaries (together with SGRP, collectively, the “Company” or the “SPAR Group”) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X.

Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included in these interim financial statements. However, these interim financial statements should be read in conjunction with the annual consolidated financial statements and notes thereto for the Company as contained in the Company’s Annual Report for 2007 on Form 10-K for the year ended December 31, 2007, as filed with the Securities and Exchange Commission (the “SEC”) on March 31, 2008, (the “Company’s Annual Report for 2007 on Form 10-K”). 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 Company is a supplier of merchandising and other marketing services throughout the United States and internationally. The Company also provides in-store event staffing, product sampling, radio frequency identification (“RFID”) services, technology services and marketing research.

Today the Company operates in 13 countries whose population represents approximately 48% of the total world population. The Company’s operations are currently divided into two divisions: the Domestic Merchandising Services Division and the International Merchandising Services Division. The Domestic Merchandising Services Division provides merchandising and marketing services, in-store event staffing, product sampling, RFID services, technology services and marketing research to manufacturers and retailers in the United States. The various services are primarily performed in mass merchandisers, electronics store chains, drug store chains and convenience and grocery stores. The International Merchandising Services Division was established in July 2000 and through its subsidiaries, the Company currently provides similar merchandising and marketing services in Japan, Canada, Turkey, South Africa, India, Romania, China, Lithuania, Latvia, Estonia, Australia and New Zealand. The Company continues to focus on expanding its merchandising and marketing services business throughout the world.

## SPAR Group, Inc.

## Notes to Consolidated Financial Statements

(unaudited) (continued)

**3. Earnings Per Share**

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

|  | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |             |
|--|--------------------------------|------------|------------------------------|-------------|
|  | 2008                           | 2007       | 2008                         | 2007        |
| Numerator:   |                                |            |                              |             |
| Net income (loss)  | \$ 3                           | \$(1,739 ) | \$ (247 )                    | \$ (2,247 ) |
| Denominator:   |                                |            |                              |             |
| Shares used in basic net income (loss) per share calculation | 19,137                         | 18,934     | 19,137                       | 18,934      |
| Effect of diluted securities:                                |                                |            |                              |             |
| Employee stock options                                       | —                              | —          | —                            | —           |
| Shares used in diluted net loss per share calculation        | 19,137                         | 18,934     | 19,137                       | 18,934      |
| Basic and diluted net loss per common share                  | \$ —                           | \$(0.09 )  | \$ (0.01 )                   | \$ (0.12 )  |

**4. Lines of Credit**

In January 2003, the Company (other than SGRP's foreign subsidiaries) and Webster Business Credit Corporation, then known as Whitehall Business Credit Corporation ("Webster"), entered into the Third Amended and Restated Revolving Credit and Security Agreement (as amended, collectively, the "Credit Facility"). The Credit Facility provides for a \$5.0 million revolving line of credit maturing on January 23, 2009. In March 2007 the credit facility was further amended to, among other things, delay the Minimum Fixed Coverage ratio until the fourth quarter 2007, establish an EBITDA covenant and increase the interest rate by .25% beginning March 28, 2007. In May 2007 the credit facility was amended to provide for an availability reserve of \$500,000. In August 2007 the credit facility was further amended to reduce the availability reserve to \$250,000 until November 30, 2007. On November 16, 2007 Webster amended the credit facility to extend the availability reserve of \$250,000 indefinitely and to reduce the revolving line of credit from \$7.0 to \$5.0 million. In February 2008 the Credit Facility was amended to establish monthly EBITDA covenants until September 30, 2008 and to set a Fixed Charged Coverage Ratio covenant for the year ended December 31, 2008. Borrowings are based upon a borrowing base formula as defined in the agreement (principally 85% of "eligible" domestic accounts receivable less certain reserves). The Credit Facility is secured by all of the assets of the Company and its domestic subsidiaries. The Credit Facility also limits certain expenditures, including, but not limited to, capital expenditures and other investments. In addition, Mr. Robert G. Brown, a Director, the Chairman and a major stockholder of SGRP, and Mr. William H. Bartels, a Director, the Vice Chairman and a major stockholder of SGRP, have provided personal guarantees of the Credit Facility totaling \$1.0 million.

The basic interest rate under the Credit Facility is Webster's "Alternative Base Rate" plus 1.0% per annum (a total of 6.0% per annum at June 30, 2008), which automatically changes with each change made by Webster in such Alternative Base Rate. The Company at its option, subject to certain conditions, may elect to have portions of its loans under the Credit Facility bear interest at various LIBOR rates plus 3.25% per annum based on fixed interest



**SPAR Group, Inc.**

**Notes to Consolidated Financial Statements**

**(unaudited) (continued)**

periods of one, two, three or nine months. The actual average interest rate under the Credit Facility was 6.57% per annum for the six months ended June 30, 2008.

The domestic revolving loan balances outstanding under the Credit Facility were \$3.9 million and \$4.9 million at June 30, 2008 and December 31, 2007, respectively. As of June 30, 2008, the SPAR Group had unused availability under the Credit Facility of \$44,000 out of the remaining maximum \$1.1 million unused revolving line of credit after reducing the borrowing base by outstanding loans.

Because of the requirement to maintain a lock box arrangement with Webster and Webster's ability to invoke a subjective acceleration clause at its discretion, borrowings under the Credit Facility are classified as current at June 30, 2008 and December 31, 2007, in accordance with EITF 95-22, Balance Sheet Classification of Borrowings Outstanding Under Revolving Credit Agreements that include both a Subjective Acceleration Clause and a Lock-Box Agreement.

The Company was in violation of its April 2008 covenant (and has received a waiver for the violation). The Company was not in violation as of June 30, 2008, and does not expect to be in violation at future measurement dates. However, there are no assurances that the Company will not be in violation of certain covenants in the future. Should the Company be in violation, there are no assurances that Webster will issue waivers for any future violations.

The Japanese subsidiary, SPAR FM Japan, Inc., has line of credit agreements totaling 100 million Yen, or approximately \$948,000 (based upon the exchange rate at June 30, 2008). The outstanding balances under the line of credit agreements were 50 million Yen, or \$474,000 at June 30, 2008 and 90 million Yen, or \$802,000 at December 31, 2007 (based upon the exchange rate at those dates). The average interest rate was 2.45% per annum for the six months ended June 30, 2008. In addition, the Japan subsidiary had cash balances totaling 191 million Yen, or approximately \$1.8 million and 137 million Yen, or approximately \$1.2 million at June 30, 2008 and December 31, 2007 respectively (based upon the exchange rates at those dates).

The Australian subsidiary, SPARFACTS Australia Pty. Ltd., has a revolving line of credit arrangement with Oxford Funding Pty. Ltd. for \$1.1 million (Australian) or approximately \$1.0 million (based upon the exchange rate at June 30, 2008). The outstanding balances under the line of credit agreements were \$268,000 (Australian), or \$249,000 at June 30, 2008 and a balance of \$315,000 (Australian) or \$276,000 at December 31, 2007 (based upon the exchange rate at those dates). The average interest rate was 12.7% per annum for the six months ended June 30, 2008.

SPAR Canada Company, a wholly owned subsidiary, has a credit agreement with Royal Bank of Canada providing for a Demand Operating Loan for a maximum borrowing of \$750,000 (Canadian) or \$743,000 (based upon the exchange rate at June 30, 2008). The Demand Operating Loan provides for borrowings based upon a borrowing base formula as defined in the agreement (principally 75% of eligible accounts receivable less certain deductions). The outstanding balances under the line of credit agreement were \$500,000 (Canadian) or \$495,000 and \$140,000 (Canadian) or \$143,000 at June 30, 2008 and December 31, 2007, respectively (based upon the exchange rate at those dates). The average interest rate was 5.75% per annum for the six months ended June 30, 2008.

**5. Capital Lease Obligations**

In 2007, the Company capitalized certain equipment leases. The economic substance of the leases is such that the Company is financing the acquisition of the assets through the leases. The equipment has a cost of \$582,000, accumulated depreciation of \$234,000 and a net book value of \$348,000 at June 30, 2008.

## SPAR Group, Inc.

## Notes to Consolidated Financial Statements

(unaudited) (continued)

Annual future minimum lease payments required under the leases, together with their present value as of June 30, 2008 are as follows:

| Year Ending<br><u>December 31:</u>                           | Amount    |
|--|-----------|
| 2008   | \$111,000 |
| 2009   | 223,000   |
| 2010   | 97,000    |
|  | 431,000   |
| Less amount representing interest                            | 49,000    |
| Present value of net minimum lease payments                  | 382,000   |
| Less current portion included with other current liabilities | 182,000   |
| Long-term portion included with other long-term liabilities  | \$200,000 |

#### 6. Related-Party Transactions

Mr. Robert G. Brown, a Director, the Chairman and a major stockholder of SGRP, and Mr. William H. Bartels, a Director, the Vice Chairman and a major stockholder of SGRP, are executive officers and the sole stockholders and directors of SPAR Marketing Services, Inc. ("SMS"), SPAR Management Services, Inc. ("SMSI"), and SPAR Infotech, Inc. ("SIT").

SMS and SMSI provided 99% of the Company's domestic merchandising specialists field force (through independent contractors) for both the six months ended June 30, 2008 and 2007, and 84% and 83% of the Company's domestic field management, at a total cost to the Company of approximately \$9.9 million and \$8.5 million for the six months ended June 30, 2008 and 2007, respectively. Pursuant to the terms of the Amended and Restated Field Service Agreement dated as of January 1, 2004, SMS provides the services of SMS's merchandising specialist field force of approximately 4,100 independent contractors to the Company. Pursuant to the terms of the Amended and Restated Field Management Agreement dated as of January 1, 2004, SMSI provides 48 full-time national, regional and district managers to the Company. For those services, the Company has agreed to reimburse SMS and SMSI for all of their costs of providing those services and to pay SMS and SMSI each a premium equal to 4% of their respective costs. Total net premiums (4% of SMS and SMSI costs) paid to SMS and SMSI for services rendered were \$378,000 and \$348,000 for the six months ended June 30, 2008, and 2007, respectively. The Company has been advised that Messrs. Brown and Bartels are not paid any salaries as officers of SMS or SMSI so there were no salary reimbursements for them included in such costs or premium. However, since SMS and SMSI are "Subchapter S" corporations and are owned by Messrs. Brown and Bartels, they benefit from any income of such companies allocated to them.

SIT provided substantially all of the Internet computer programming services purchased by the Company at a total cost of \$359,000 and \$337,000 for the six months ended June 30, 2008 and 2007, respectively. SIT provided approximately 12,000 and 10,500 hours of Internet computer programming services to the Company for the six months ended June 30, 2008 and 2007, respectively. Pursuant to the Amended and Restated Programming and Support Agreement dated as of September 15, 2007, SIT continues to provide programming services to the Company for which the Company has agreed to pay SIT competitive hourly wage rates for time spent on Company matters and to reimburse the related out-of-pocket expenses of SIT and its personnel. The average hourly billing rate was \$29.92 and \$31.92 for the six months ended June 30, 2008 and 2007, respectively. The Company has been advised that no hourly charges or business expenses for Messrs. Brown and Bartels were charged to the Company by SIT for the six months ended June 30, 2008 and 2007, respectively. However, since SIT is a "Subchapter S" corporation and is owned by Messrs. Brown and Bartels, they benefit from any income of such company allocated to them.



**SPAR Group, Inc.****Notes to Consolidated Financial Statements****(unaudited) (continued)**

In November 2004 and January 2005, the Company entered into separate operating lease agreements between SMS and the Company's wholly owned subsidiaries, SPAR Marketing Force, Inc. ("SMF") and SPAR Canada Company ("SPAR Canada"), respectively. In March 2005 SMF entered into an additional operating lease with SMS. Each lease had a term of 36 months. The equipment leased by SMF and SPAR Canada was handheld computers and the total monthly lease expense for SMF and SPAR Canada was \$20,232 and \$2,972, respectively.

By March 31, 2008, all of the operating leases noted above had expired. Both SMF and SPAR Canada elected to notify SMS of its intention to continue to lease the equipment for an additional twelve month period. The extended lease payments are based upon the fair market value of the equipment as of the expiration dates and an effective interest rate of 10% per annum. The revised monthly lease payments are \$10,050 for SMF and \$1,500 for SPAR Canada. SMF and SPAR Canada accrued the cost of the revised lease payments since the expiration of the original leases and as of June 30, 2008 SMS forgave the total indebtedness for the accrued monthly lease amounts that were due as of June 30, 2008 totaling \$74,000.

In addition to the \$74,000 in operating lease payments SMS forgave, SMSI also forgave \$100,000 that was owed by the Company for field management expenses as of March 31, 2008. SMSI also forgave an additional \$100,000 of the Company's indebtedness in exchange for 89,286 shares of Preferred Stock (see Note 16, Preferred Stock).

Through arrangements with the Company, SMS, SMSI and SIT participate in various benefit plans, insurance policies and similar group purchases by the Company, for which the Company charges them their allocable shares of the costs of those group items and the actual costs of all items paid specifically for them. All transactions between the Company and the above affiliates are paid and/or collected by the Company in the normal course of business.

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

|   | <b>Three Months Ended June 30,</b> |             | <b>Six Months Ended June 30,</b> |             |
|---|------------------------------------|-------------|----------------------------------|-------------|
|   | <b>2008</b>                        | <b>2007</b> | <b>2008</b>                      | <b>2007</b> |
| Services provided by affiliates:                        |                                    |             |                                  |             |
| Independent contractor services (SMS)                   | \$ 4,480                           | \$ 3,046    | \$ 7,921                         | \$ 6,917    |
| Field management services (SMSI)                        | \$ 934                             | \$ 776      | \$ 1,930                         | \$ 1,569    |
| Handheld computer leases (SMS)                          | \$ —                               | \$ 69       | \$ 7                             | \$ 139      |
| Internet and software program Consulting services (SIT) | \$ 171                             | \$ 171      | \$ 359                           | \$ 337      |

|                                       | <b>June 30,</b> | <b>December 31,</b> |
|---------------------------------------|-----------------|---------------------|
|                                       | <b>2008</b>     | <b>2007</b>         |
| Accrued expenses due to affiliates:   |                 |                     |
| SPAR Marketing Services, Inc. (SMS)   | \$ 1,988        | \$ 1,490            |
| SPAR Management Services, Inc. (SMSI) | 271             | 457                 |
| SPAR Infotech, Inc. (SIT)             | 84              | 160                 |

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|  |    |              |    |       |
|--|----|--------------|----|-------|
| Total accrued expenses due to affiliates | \$ | <b>2,343</b> | \$ | 2,107 |
|--|----|--------------|----|-------|

In addition to the above, through the services of Affinity Insurance, Ltd. (“Affinity”), the Company purchases insurance coverage for its casualty and property insurance risk. The Company’s Chairman and Vice Chairman own, through SMSI, a minority (less than 5%) equity interest in Affinity.

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**SPAR Group, Inc.**

**Notes to Consolidated Financial Statements**

(unaudited) (continued)

**7. Stock-Based Compensation**

The Company grants options to purchase shares of the Company's common stock to its employees and certain employees of its affiliates. Under SFAS No. 123(R), the Company accounts for its employee and affiliate employee stock option expense as compensation expense in the Company's financial statements when the stock options are granted. 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. The fair value of the option continues to be updated through the vesting date. The options granted have a ten (10) year life and vest over four-year periods at a rate of 25% per year, beginning on the first anniversary of the date of grant.

Based upon the Black-Scholes calculation, share-based compensation expense related to employee stock option grants totaled \$85,000 and \$129,000 for the six months ended June 30, 2008 and 2007 respectively. Compensation expense related to non-employee stock option grants awarded to the employees of the Company's affiliates was \$48,000 and \$35,000 for the six months ended June 30, 2008 and 2007, respectively. The impact of the total share-based compensation expense on basic/diluted earnings per share was approximately \$0.01 for both the six months ended June 30, 2008 and 2007.

**8. Customer Deposits**

Customer deposits at June 30, 2008, were \$651,000 (\$34,000 from domestic operations and \$617,000 from international operations) compared to \$580,000 at December 31, 2007 (\$120,000 from domestic operations and \$460,000 from international operations).

**9. Commitments and Contingencies**

**International Commitments**

The Company's international business model is to partner with local merchandising companies and combine the Company's proprietary software and expertise in the merchandising and marketing services business with their partner's knowledge of the local market. In 2001, the Company established its Japanese subsidiary to provide the latest in-store merchandising and marketing services to the Japanese market. Since 2003, the Company has expanded its international presence to Canada, Turkey, South Africa, India, Romania, China, Lithuania, Latvia, Estonia, Australia, and New Zealand. Today the Company has nine subsidiaries operating in 13 countries whose population represents approximately 48% of the total world population.

Certain of these subsidiaries are profitable, while others are operating at a loss. In the event certain subsidiaries have continued losses, the Company may be required to make additional cash infusions into those subsidiaries.

**Legal Matters**

Safeway Inc. ("Safeway") filed a Complaint against PIA Merchandising Co., Inc. ("PIA Co."), a wholly owned subsidiary of SPAR Group, Inc. ("SGRP"), Pivotal Sales Company ("Pivotal"), a wholly owned subsidiary of PIA Co., and SGRP in Alameda Superior Court, case no. 2001028498 on October 24, 2001. Safeway claims, as subsequently amended, alleged causes of action for breach of contract and breach of implied contract. PIA Co. and Pivotal filed cross-claims against Safeway on or about March 11, 2002, and amended them on or about October 15, 2002, alleging causes of action by PIA Co. and Pivotal against Safeway for breach of contract, interference with economic relationship, unfair trade practices and unjust enrichment. Trial commenced in March 2006.

On May 26, 2006, the jury in this case returned a verdict resulting in a net award of \$1,307,700 to Pivotal, a SGRP subsidiary. This net award is to be paid by Safeway and resulted from separate jury findings that awarded damages to those SGRP subsidiaries on certain claims and damages to Safeway on other claims. In particular, the jury awarded damages to Pivotal of \$5,760,879 for Safeway's interference with Pivotal's contractual relationships.



## SPAR Group, Inc.

## Notes to Consolidated Financial Statements

(unaudited) (continued)

with third party manufacturers and also awarded \$782,400 to Pivotal and PIA for Safeway's breach of contract with those SGRP subsidiaries. The jury awarded damages to Safeway of \$5,235,579 for breach of contract by SGRP and those SGRP subsidiaries. Judgment was entered in favor of Pivotal on August 14, 2006 for \$1,307,700. Both sides filed post trial motions but all post trial motions were denied. Notices of Appeal were thereafter filed by both Safeway and Pivotal/PIA/SGRP. Pivotal/PIA/SGRP is seeking to have Safeway's award overturned, thereby increasing the award to Pivotal by over \$5 million. Safeway is seeking to have overturned the \$5,760,879 award against it for interference with contractual relationships. With the appeals pending, the parties participated in a mediation of the dispute, but it was not successful in resolving the matter. Accordingly, the appeals are proceeding.

Briefing on the appeals commenced in the second quarter of 2008, it is expected that opposition and reply briefs will be completed by March 2009. Thereafter, an oral argument hearing date will be assigned by the court of appeal. The appellate process in the California Court of Appeal is expected to last until late 2009. The Company has recorded the net \$1.3 million judgment award in other assets.

In addition to the above, the Company is a party to various other legal actions and administrative proceedings arising in the normal course of business. In the opinion of Company's management, disposition of these other matters are not anticipated to have a material adverse effect on the financial position, results of operations or cash flows of the Company.

**10. Geographic Data**

A summary of the Company's net revenues, operating income (loss) and long lived assets by geographic area for the three and six months ended June 30, 2008 and 2007, respectively, and at June 30, 2008 and December 31, 2007, are as follows (in thousands):

|                      | Three Months Ended June 30, |           | Six Months Ended June 30, |           |
|----------------------|-----------------------------|-----------|---------------------------|-----------|
|                      | 2008                        | 2007      | 2008                      | 2007      |
| <u>Net revenues:</u> |                             |           |                           |           |
| United States        | \$ 8,897                    | \$ 5,912  | \$ 16,340                 | \$ 14,345 |
| International        | 10,013                      | 6,594     | 20,024                    | 13,574    |
| Total net revenues   | \$ 18,910                   | \$ 12,506 | \$ 36,364                 | \$ 27,919 |

|                                 | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|---------------------------------|-----------------------------|------------|---------------------------|------------|
|                                 | 2008                        | 2007       | 2008                      | 2007       |
| <u>Operating income (loss):</u> |                             |            |                           |            |
| United States                   | \$ 317                      | \$ (1,237) | \$ 84                     | \$ (1,511) |
| International                   | 143                         | (345)      | 480                       | (360)      |
| Total operating income (loss)   | \$ 460                      | \$ (1,582) | \$ 564                    | \$ (1,871) |

|                           | June 30, | December 31, |
|---------------------------|----------|--------------|
|                           | 2008     | 2007         |
| <u>Long lived assets:</u> |          |              |
| United States             | \$ 3,734 | \$ 3,706     |
| International             | 320      | 268          |
| Total long lived assets   | \$ 4,054 | \$ 3,974     |

International revenues disclosed above were based upon revenues reported by the Company's nine international subsidiaries. The Japan subsidiary contributed 14.7% and 14.2% of the consolidated net revenues of

## SPAR Group, Inc.

## Notes to Consolidated Financial Statements

(unaudited) (continued)

the Company for the three months ended June 30, 2008 and 2007, respectively, and 16.9% and 16.5% of the Company's net revenues for the six months ended June 30, 2008 and 2007, respectively. The Canadian subsidiary contributed 12.0% and 10.0% of the consolidated net revenues of the Company for the three months ended June 30, 2008 and 2007, respectively, and 11.1% and 8.9% of the Company's net revenues for the six months ended June 30, 2008 and 2007, respectively. The Australian subsidiary contributed 10.9% and 13.1% of the consolidated net revenues of the Company for the three months ended June 30, 2008 and 2007, respectively, and 11.2% and 10.8% of the Company's net revenues for the six months ended June 30, 2008 and 2007, respectively. Each of the remaining six foreign subsidiaries contributed, in total, 15.4% for both the three months ended June 30, 2008 and 2007 and 15.9% and 12.5% of the Company's net revenues for the six months ended June 30, 2008 and 2007, respectively.

## 11. Supplemental Balance Sheet Information

|   | June 30,<br>2008 | December 31,<br>2007 |
|---|------------------|----------------------|
| Accounts receivable, net, consists of the following (in thousands): |                  |                      |
| Trade   | \$ 8,804         | \$ 9,833             |
| Unbilled  | 4,422            | 3,789                |
| Non-trade   | 409              | 289                  |
|   | 13,635           | 13,911               |
| Less allowance for doubtful accounts                                | (114 )           | (163 )               |
| Accounts receivable, net  | \$ 13,521        | \$ 13,748            |

|  | June 30,<br>2008 | December 31,<br>2007 |
|--|------------------|----------------------|
| Property and equipment, net, consists of the following (in thousands): |                  |                      |
| Equipment  | \$ 6,933         | \$6,781              |
| Furniture and fixtures   | 568              | 625                  |
| Leasehold improvements   | 245              | 245                  |
| Capitalized software development costs                                 | 2,056            | 1,837                |
|  | 9,802            | 9,488                |
| Less accumulated depreciation and amortization                         | 8,270            | 7,960                |
| Property and equipment, net  | \$ 1,532         | \$ 1,528             |

|   | June 30,<br>2008 | December 31,<br>2007 |
|---|------------------|----------------------|
| Accrued expenses and other current liabilities consist of the following (in thousands): |                  |                      |
| Taxes payable   | \$ 534           | \$ 664               |
| Accrued accounting and legal expense  | 283              | 227                  |

|  |                 |          |
|--|-----------------|----------|
| Accrued salaries payable                       | <b>1,365</b>    | 1,304    |
| Other  | <b>2,415</b>    | 1,786    |
| Accrued expenses and other current liabilities | <b>\$ 4,597</b> | \$ 3,981 |

**12. Foreign Currency Rate Fluctuations**

The Company has foreign currency exposure with its international subsidiaries. In both 2008 and 2007, these exposures are primarily concentrated in the Canadian Dollar, Australian Dollar and Japanese Yen. At June 30,

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**SPAR Group, Inc.****Notes to Consolidated Financial Statements****(unaudited) (continued)**

2008, international assets totaled \$9.8 million and international liabilities totaled \$13.8 million. International revenues for the six months ended June 30, 2008 and 2007 were \$20.0 million and \$13.6 million, respectively. The international division reported a net income (loss) of approximately \$257,000 and (\$508,000) for the six months ended June 30, 2008 and 2007, respectively.

In those countries where the Company had the greater risk for foreign currency exposure, the total assets and liabilities are as follows (in thousands) in U.S. Dollars based on the June 30, 2008, exchange rates:

| Country   | Total Assets | Total Liabilities |
|-----------|--------------|-------------------|
| Canada    | \$ 1,452     | \$ 783            |
| Australia | 1,779        | 1,219             |
| Japan     | 3,175        | 2,748             |

**13. Interest Rate Fluctuations**

The Company is exposed to market risk related to the variable interest rate on its lines of credit. At June 30, 2008, the Company's outstanding lines of credit totaled approximately \$5.1 million, as noted in the table below (in thousands):

| Location      | Variable Interest Rate <sup>(1)</sup> | Local Currency Amount | US Dollars Equivalent <sup>(2)</sup> |
|---------------|---------------------------------------|-----------------------|--------------------------------------|
| United States | 6.00%                                 | 3,911USD              | \$ 3,911                             |
| Japan         | 2.45%                                 | 50,000YEN             | 474                                  |
| Australia     | 12.7%                                 | 268AUD                | 249                                  |
| Canada        | 5.75%                                 | 500CAD                | 495                                  |
|               |                                       |                       | \$ 5,129                             |

(1) Based on interest rate at June 30, 2008.

(2) Based on exchange rate at June 30, 2008.

Based on the 2008 average outstanding borrowings under variable-rate debt, a one-percentage point increase in interest rates would negatively impact pre-tax earnings and cash flows for the six months ended June 30, 2008 by approximately \$28,000.

**14. Recently Issued Accounting Standards**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements". The statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements. SFAS No. 157 is effective January 1, 2008, for financial assets and liabilities and January 1, 2009 for non-financial assets and liabilities. There was no material impact from this statement on the Company's financial condition and results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – including an amendment of FASB Statement No. 115" ("SFAS No. 159"), which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and





**SPAR Group, Inc.**

**Notes to Consolidated Financial Statements**

**(unaudited) (continued)**

liabilities to be carried at fair value. SFAS No. 159 does not eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157 and SFAS No. 107, "Disclosures about Fair Value of Financial Instruments." SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. There was no material impact from this statement on the Company's financial condition and results of operations.

In December 2007, the FASB issued SFAS No. 141(Revised), "Business Combinations" ("SFAS No. 141(R)"), which replaces SFAS No. 141, "Business Combinations," and requires an acquirer to recognize the assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions. This statement also requires the acquirer in a business combination achieved in stages to recognize the identifiable assets and liabilities, as well as the non-controlling interest in the acquiree, at the full amounts of their fair values. SFAS No. 141(R) makes various other amendments to authoritative literature intended to provide additional guidance or to confirm the guidance in that literature to that provided in this statement. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company expects to adopt this statement on January 1, 2009. SFAS No. 141(R)'s impact on accounting for business combinations is dependent upon acquisitions after the effective date.

In December 2007, FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements," which amends Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements. SFAS No. 160 establishes accounting and reporting standards that require the ownership interests in subsidiaries not held by the parent to be clearly identified, labeled and presented in the consolidated statement of financial position within equity, but separate from the parent's equity. This statement also requires the amount of consolidated net income attributable to the parent and to the non-controlling interest to be clearly identified and presented on the face of the consolidated statement of income. Changes in a parent's ownership interest while the parent retains its controlling financial interest must be accounted for consistently, and when a subsidiary is deconsolidated, any retained non-controlling equity investment in the former subsidiary must be initially measured at fair value. The gain or loss on the deconsolidation of the subsidiary is measured using the fair value of any non-controlling equity investment. The statement also requires entities to provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. This statement applies prospectively to all entities that prepare consolidated financial statements and applies prospectively for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company does not believe this statement will impact the Company's financial condition or results of operations but may impact the format of the Company's financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 161, "Disclosures about Derivative Investments and Hedging Activities, an amendment of FASB Statement No. 133", which requires additional disclosures about the objectives of the derivative instruments and hedging activities, the method of accounting for such instruments under SFAS No. 133 and its related interpretations, and a tabular disclosure of the effects of such instruments and related hedged items on the Company's financial position, financial performance, and cash flows. SFAS No. 161 is effective for the Company beginning January 1, 2009. The Company is currently assessing the potential impact, if any, that adoption of SFAS No. 161 may have in the Company's financial statements.

**15. Taxes**

In July 2006, the FASB issued FASB interpretation No. 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes. FIN 48 prescribes detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. Tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. FIN 48 is effective for fiscal years beginning after December 15, 2006 and the provisions of FIN 48 will be applied to all tax positions upon initial adoption of the Interpretation. FIN 48 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.



**SPAR Group, Inc.****Notes to Consolidated Financial Statements****(unaudited) (continued)**

SPAR and its subsidiaries file numerous consolidated, combined and separate company income tax returns in the U.S. Federal jurisdiction and in many U.S. state and foreign jurisdictions. With few exceptions, SPAR is subject to U.S. Federal, state and local income tax examinations for the years 2004 through the present. However, tax authorities have the ability to review years prior to the position taken by the Company to the extent that SPAR utilized tax attributes carried forward from those prior years.

The Company adopted the provisions of FASB Interpretation No. 48 Accounting for uncertainty in Income Taxes, on January 1, 2007. In management's view, the Company's tax reserves at June 30, 2008, totaling \$188,000 for potential domestic state tax and federal tax liabilities were sufficient to meet the requirements of FIN 48. The reserve for potential international tax liabilities totaling \$177,000 was deemed to no longer be required and was released as of June 30, 2008.

|  |           |
|--|-----------|
| Balance at January 1, 2008               | \$339,000 |
| Additions to state tax position          | 26,000    |
| Reduction to international tax positions | (177,000) |
| Balance at January 1, 2008               | \$188,000 |

**16. Preferred Stock**

On March 28, 2008, SGRP filed a "Certificate of Designation of Series "A" Preferred Stock of SPAR Group, Inc." (the "Preferred Designation"), creating a series of 3,000,000 shares of Preferred Stock designated as "Series A Preferred Stock" with a par value of \$0.01 per share (the "Preferred Stock"), which designation had been approved by SGRP's Board of Directors (the "Board") on March 27, 2008.

The Preferred Designation provides that each share of Preferred Stock is to be issued at a value equal to the closing bid price of SGRP's common stock (the "Common Stock") immediately preceding the day SGRP and the purchaser(s) entered into a binding commitment to issue and acquire Preferred Stock. The Preferred Stock will accrue a 10% dividend payable in either cash (when permitted by law and Nasdaq and authorized by the Board) or common stock when authorized by the Board (valued at the current market price of a share of common stock at the time paid but not less than the initial purchase price of a share of such preferred). All accrued and unpaid dividends and potential dividends must be paid to the holders of the Preferred Stock before any dividends can be paid to the holders of the Common Stock. The face value (purchase price) of the Preferred Stock and all accrued and unpaid dividends and potential dividends must be paid to the holders of the Preferred Stock before any liquidating distributions can be made to the holders of the Common Stock. The consent of all of the holders of the Preferred Stock is required for SGRP to make any changes in the Preferred Designation or issue any other class of preferred stock senior to or pari passu with the Preferred Stock.

The Preferred Stock is redeemable, at the discretion of SGRP only, for a cash redemption price equal to its face value (purchase price) plus all accrued and unpaid dividends and potential dividends. Each share of Preferred Stock is convertible into one share of Common Stock at the rate of one to one at the option of the holder, which option would be exercisable for so long as the Preferred Stock is outstanding (even if SGRP has elected to redeem). Such a conversion also requires that SGRP satisfy all accrued and unpaid dividends and potential dividends at the same time. The Preferred Stock votes with the Common Stock (no class voting) and have voting rights equal to one vote per share of Preferred Stock.

On March 27, 2008, the Board also authorized the issuance of up to 530,000 shares of Preferred Stock to its affiliates, Robert G. Brown and William H. Bartels (who are officers, directors and significant shareholders of SGRP - see Note 6, Related-Party Transactions) in return for (among other things) cash or the reduction of an equivalent debt owed by the Company to SPAR Management Services, Inc. ("SMSI"), an affiliate of SGRP wholly



**SPAR Group, Inc.**

**Notes to Consolidated Financial Statements**

**(unaudited) (continued)**

owned by Mr. Brown and Mr. Bartels. On March 31, 2008, SGRP, Mr. Brown, Mr. Bartels and SMSI entered into an agreement to issue and purchase 89,286 shares of Preferred Stock at \$1.12 per share (the closing bid price of SGRP's Common Stock for the most recent trading day available immediately preceding such agreement date). Pursuant to that agreement, SGRP's payable to SMSI was reduced by \$100,000, and SGRP issued 54,564 shares of Preferred Stock to Mr. Brown and 34,722 shares of Preferred Stock to Mr. Bartels, all effective March 31, 2008. SGRP's Audit Committee reviewed and unanimously approved this transaction, including the terms of the Preferred Stock and the affiliated relationship of the parties. The offer and sale of such Preferred Stock have not been registered under the Securities Act or other securities laws, as they were a non-public offer and sale made in reliance upon (among other things) Section 4 (2) of the Securities Act.

**17. Reclassifications**

Certain reclassifications have been made to the 2007 financial statements to conform with the 2008 presentation.

SPAR Group, Inc.

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

Statements contained in this Quarterly Report on Form 10-Q for the three months ended March 31, 2008 (this "Quarterly Report"), of SPAR Group, Inc. ("SGRP", and together with its subsidiaries, the "SPAR Group" or the "Company"), include "forward-looking statements" (within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act", and together with the Securities Act, the "Securities Laws") that are based on the Company's best estimates. In particular and without limitation, this "Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources" contains such forward-looking statements, which are included in (among other places) the discussions respecting net revenues from significant clients, significant chain work and international joint ventures, federal taxes and net operating loss carry forwards, commencement of operations and future funding of international joint ventures, credit facilities and covenant compliance, cost savings initiatives, liquidity and sources of cash availability. Forward-looking statements involve known and unknown risks, uncertainties and other factors that could cause the Company's actual results, performance and achievements, whether expressed or implied by such forward-looking statements, to not occur, to not be realized or to be less than expected. Such forward-looking statements generally are based upon the Company's best estimates of future results, performance or achievement, current conditions and the most recent results of operations. Forward-looking statements may be identified by the use of forward-looking terminology such as "may", "will", "likely", "expect", "intend", "believe", "estimate", "anticipate", "continue" or similar terms, variations of those terms or the negative of those terms. You should carefully consider such risks, uncertainties and other information, disclosures and discussions containing cautionary statements or identifying important factors that could cause actual results to differ materially from those provided in the forward-looking statements.

You should carefully review this management discussion and analysis together with the risk factors and other cautionary statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007, as filed with the Securities and Exchange Commission (the "SEC") on March 31, 2008 (the "Company's Annual Report for 2007 on Form 10-K"), including the risk factors described in Item 1A of that annual report under the caption "Certain Risk Factors" and the changes (if any) in such risk factors described in Item 1A of Part II of this Quarterly Report (collectively, "Risk Factors"), as well as the cautionary statements contained in this Quarterly Report. All forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified by the Risk Factors and other cautionary statements in this Quarterly Report and in the Company's Annual Report for 2007 on Form 10-K, which are incorporated by reference into this Quarterly Report. Although the Company believes that its plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, the Company cannot assure that such plans, intentions or expectations will be achieved in whole or in part, that it has identified all potential risks or that it can successfully avoid or mitigate such risks in whole or in part. The Company undertakes no obligation to publicly update or revise any forward-looking statements, or any Risk Factors or other cautionary statements, whether as a result of new information, future events or otherwise, except as required by law.

**Overview**

Today the Company operates in 13 countries whose population represents approximately 48% of the total world population. The Company's operations are currently divided into two divisions: the Domestic Merchandising Services Division and the International Merchandising Services Division. The Domestic Merchandising Services Division provides merchandising and marketing services, in-store event staffing, product sampling, RFID services, technology services and marketing research to manufacturers and retailers in the United States. The various services are primarily performed in mass merchandisers, electronics store chains, drug store chains and convenience and grocery stores. The International Merchandising Services Division was established in July 2000 and through its subsidiaries, the Company currently provides similar merchandising and marketing services in Japan, Canada, Turkey, South Africa, India, Romania, China, Lithuania, Latvia, Estonia, Australia and New Zealand.

**SPAR Group, Inc.*****Domestic Merchandising Services Division***

The Company's Domestic Merchandising Services Division provides nationwide merchandising and other marketing services primarily on behalf of consumer product manufacturers and retailers at mass merchandisers, electronics store chains, drug store chains and grocery stores. Included in its clients are home entertainment, general merchandise, health and beauty care, consumer goods and food product companies in the United States.

Merchandising and marketing services primarily consist of regularly scheduled dedicated routed services and special projects provided at the store level for a specific retailer or single or multiple manufacturers or distributors. Services also include stand-alone large-scale implementations. These services may include sales enhancing activities such as ensuring that client products authorized for distribution are in stock and on the shelf, adding new products that are approved for distribution but not presently on the shelf, setting category shelves in accordance with approved store schematics, ensuring that shelf tags are in place, checking for the overall salability of client products and setting new and promotional items and placing and/or removing point of purchase and other related media advertising. Specific in-store services can be initiated by retailers or manufacturers or distributors, and include new store openings and existing store resets, re-merchandising, remodels and category implementations, new product launches, special seasonal or promotional merchandising, focused product support and product recalls. The Company also provides in-store product demonstrations, in-store product sampling and other in-store event staffing services, RFID services, technology services and marketing research services.

***International Merchandising Services Division***

In July 2000, the Company established its International Merchandising Services Division, operating through a wholly owned subsidiary, SPAR Group International, Inc. ("SGI"), to focus on expanding its merchandising and marketing services business worldwide. Currently, the Company's international subsidiaries are as follows:

| Headquarter<br>Location | Ownership Percentage | Date<br>Established |
|-------------------------|----------------------|---------------------|
| Osaka, Japan            | 50%                  | May 2001            |
| Toronto, Canada         | 100%                 | June 2003           |
| Istanbul, Turkey        | 51%                  | July 2003           |
| Durban, South Africa    | 51%                  | April 2004          |
| New Delhi, India        | 51%                  | April 2004          |
| Bucharest, Romania      | 51%                  | December 2004       |
| Hong Kong, China        | 50%                  | February 2005       |
| Siauliai, Lithuania     | 51%                  | September 2005      |
| Melbourne, Australia    | 51%                  | April 2006          |

**Critical Accounting Policies**

There were no material changes during the six months ended June 30, 2008, to the Company's critical accounting policies as reported in the Company's Annual Report for 2007 on Form 10-K.





## SPAR Group, Inc.

## Results of Operations

Three months ended June 30, 2008, compared to three months ended June 30, 2007

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

|  | Three Months Ended June 30, |       |            |        |            |  |  |  |
|--|-----------------------------|-------|------------|--------|------------|--|--|--|
|  | 2008                        |       | 2007       |        | Increase/  |  |  |  |
|  | \$                          | %     | \$         | %      | (decrease) |  |  |  |
| Net revenues   | \$ 18,910                   | 100.0 | \$ 12,506  | 100.0  | 51.2       |  |  |  |
| Cost of revenues   | 13,719                      | 72.5  | 8,757      | 70.0   | 56.7       |  |  |  |
| Selling, general & administrative expense                        | 4,510                       | 23.8  | 5,137      | 41.1   | (12.2)     |  |  |  |
| Depreciation and amortization                                    | 221                         | 1.2   | 194        | 1.6    | 13.9       |  |  |  |
| Interest expense   | 81                          | 0.4   | 93         | 0.7    | (12.9)     |  |  |  |
| Other expense  | 521                         | 2.8   | 18         | 0.1    | N/A        |  |  |  |
| Loss before income tax provision (benefit) and minority interest | (142)                       | (0.8) | (1,693)    | (13.5) | (91.6)     |  |  |  |
| Provision for income taxes (benefit)                             | (185)                       | (1.0) | 74         | 0.6    | N/A        |  |  |  |
| Income (loss) before minority interest                           | 43                          | 0.2   | (1,767)    | (14.1) | (102.5)    |  |  |  |
| Minority interest  | 40                          | 0.2   | (28)       | (0.2)  | N/A        |  |  |  |
| Net income (loss)  | \$ 3                        | 0.0   | \$ (1,739) | (13.9) | (100.1)    |  |  |  |

## Net Revenues

Net revenues for the three months ended June 30, 2008, were \$18.9 million, compared to \$12.5 million for the three months ended June 30, 2007, an increase of \$6.4 million or 51.2%.

International net revenues totaled \$10 million for the three months ended June 30, 2008, compared to \$6.6 million for the same period in 2007, an increase of \$3.4 million or 51.5%. The increase in 2008 international net revenues was due to net revenue increases provided by the following countries based on expansion from existing clients and new business in; Canada \$1.0 million, Japan \$995,000, China \$442,000, Australia \$426,000, India \$353,000, Turkey \$268,000 and South Africa \$23,000 partially offset by net revenue decreases in Romania \$64,000 and Lithuania \$37,000.

Domestic net revenues totaled \$8.9 million in the three months ended June 30, 2008, compared to \$5.9 million for the same period in 2007. Domestic net revenues increased \$3.0 million due to an increase in project revenue.

Approximately 8% and 14% of the Company's net revenues for the three months ended June 30, 2008 and 2007, respectively, resulted from merchandising services performed for clients at a leading domestic electronics chain. Services performed for these clients in that electronics chain also accounted for approximately 3% and 10% of the Company's accounts receivable at June 30, 2008 and December 31, 2007, respectively. The Company's contractual relationships or agreements are with various clients and not that retail electronics chain.

One client accounted for 6% and 8% of the Company's net revenues for the three months ended June 30, 2008 and 2007, respectively. The client accounted for approximately 3% of the Company's accounts receivable at both June 30, 2008 and December 31, 2007.

The loss of the ability to provide merchandising and marketing services in the above and/or other chains or the loss of this client or other clients could significantly decrease the Company's revenues and could have a material adverse effect on the Company's business, results of operations and financial condition.



**SPAR Group, Inc.**

**Cost of Revenues**

Cost of revenues consists of in-store labor and field management wages, related benefits, travel and other direct labor-related expenses. Cost of revenues was 72.5% of net revenues for the three months ended June 30, 2008 and 70.0% for the three months ended June 30, 2007. The increase in cost of revenues as a percent of net revenues of 2.5% is primarily a result of international operations.

Internationally, the cost of revenues was 73.9% of net revenues for the three months ended June 30, 2008 and 66.0% of net revenues for the three months ended June 30, 2007. The international cost of revenues percentage increase was primarily attributed to a mix of higher cost margin business in Canada, China and Turkey.

Domestic cost of revenues was 71.1% of net revenues for the three months ended June 30, 2008 and 74.5% of net revenues for the three months ended June 30, 2007. The decrease in cost of revenues as a percentage of net revenues of 3.4% was due to a favorable mix of business.

Approximately 86% and 87% of the Company's domestic cost of revenues in the three months ended June 30, 2008 and 2007, respectively, resulted from in-store independent contractor and field management services purchased from certain of the Company's affiliates, SPAR Marketing Services, Inc. ("SMS"), and SPAR Management Services, Inc. ("SMSI"), respectively (see Note 6 - Related-Party Transactions).

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses include corporate overhead, project management, information technology, executive compensation, human resources, and legal and accounting expenses. As a result of continuing efforts to reduce such expenses, selling, general and administrative expenses decreased by \$627,000, or 12.2%, for the three months ended June 30, 2008, to \$4.5 million compared to \$5.1 million for the same period in 2007.

International selling, general and administrative expenses totaled \$2.5 million for the three months ended June 30, 2008, compared to \$2.6 million for the same period in 2007. The \$101,000 decrease in international selling, general and administrative expenses was primarily due to salary related expense reductions in Japan \$134,000.

Domestic selling, general and administrative expenses totaled \$2.0 million for the three months ended June 30, 2008, compared to \$2.6 million for the same period in 2007. The decrease in domestic selling, general and administrative expenses of \$527,000 was primarily due to a reduction in salary related expense of \$156,000, office related expense of \$371,000 (legal cost of \$103,000, equipment cost of \$68,000 and all other of \$200,000).

**Depreciation and Amortization**

Depreciation and amortization charges for the three months ended June 30, 2008, totaled \$221,000 and were comparable to \$194,000 for the same period in 2007.

**Interest Expense**

Interest expense decreased 14.8% to \$81,000 from \$93,000 for the three months ended June 30, 2008 and 2007, respectively. The decrease was primarily due to decreases in interest rates.

**Other Expense**

Other expense totaled \$521,000 and \$18,000 for the three months ended June 30, 2008 and 2007, respectively. Included in other expense for the three months ended June 30, 2008 was approximately \$458,000 for non-recurring legal costs, which was the primary reason for the increase in other expenses over the prior period.



**SPAR Group, Inc.**

**Income Taxes**

Income tax benefit for the three months ended June 30, 2008 was (\$185,000) resulting primarily from a FIN 48 adjustment from international operations. Income taxes for the three months ended June 30, 2007 were approximately \$74,000 for minimum domestic state taxes. There were no tax provisions for federal tax as the Company reported a loss for the three months ended June 30, 2008, and provides a valuation allowance against any benefits from operating loss carry forwards.

**Minority Interest**

Minority interest of approximately \$40,000 and (\$28,000) resulted from the net operating profits and losses of the Company's 51% owned subsidiaries and 50% owned subsidiaries for the three months ended June 30, 2008 and 2007, respectively.

**Net Income (Loss)**

The Company reported a net income of \$3,000 for the three months ended June 30, 2008, or \$0.0 per share, compared to a net loss of \$1.7 million, or (\$0.09) per share, for the corresponding period last year.

## SPAR Group, Inc.

## Results of Operations

Six months ended June 30, 2008, compared to six months ended June 30, 2007

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).

|  | Six Months Ended June 30, |        |           |        |            |     |
|--|---------------------------|--------|-----------|--------|------------|-----|
|  | 2008                      |        | 2007      |        | Increase/  |     |
|  | \$                        | %      | \$        | %      | (decrease) | %   |
| Net revenues   | \$36,364                  | 100.0% | \$27,919  | 100.0% | 30.2       | %   |
| Cost of revenues   | 26,203                    | 72.0   | 19,255    | 69.0   | 36.1       |     |
| Selling, general & administrative expense                        | 9,168                     | 25.2   | 10,144    | 36.6   | (9.6)      | )   |
| Depreciation and amortization                                    | 429                       | 1.2    | 391       | 1.4    | 9.7        |     |
| Interest expense   | 162                       | 0.4    | 181       | 0.6    | (10.5)     | )   |
| Other expense  | 564                       | 1.6    | 38        | (0.2)  |            | N/A |
| Loss before income tax provision (benefit) and minority interest | (162)                     | (0.4)  | (2,090)   | (7.4)  | (92.2)     | )   |
| Provision for income taxes (benefit)                             | (21)                      | —      | 141       | 0.5    | (114.9)    | )   |
| Loss before minority interest                                    | (141)                     | (0.4)  | (2,231)   | (7.9)  | (93.7)     | )   |
| Minority interest  | 106                       | 0.3    | 16        | 0.1    |            | N/A |
| Net loss   | \$(247)                   | (0.7)% | \$(2,247) | (8.0)% | (89.0)     | )%  |

## Net Revenues

Net revenues for the six months ended June 30, 2008, were \$36.4 million, compared to \$27.9 million for the six months ended June 30, 2007, an increase of \$8.5 million or 30.2%.

International net revenues totaled \$20.0 million for the six months ended June 30, 2008, compared to \$13.6 million for the same period in 2007, an increase of \$6.4 million or 48%. The increase in 2008 international net revenues was due to net revenue increases from Canada \$1.6 million, Japan \$1.5 million, Australia \$1.0 million, India \$868,000, China \$852,000, Turkey \$555,000 and South Africa \$146,000, partially offset by net revenue decreases in Romania \$80,000 and Lithuania \$42,000.

Domestic net revenues totaled \$16.4 million in the six months ended June 30, 2008, compared to \$14.3 million for the same period in 2007. Domestic net revenues increased \$2.1 million. The increase in domestic net revenues was due primarily to an increase in project revenues.

Approximately 9% and 13% of the Company's net revenues for the six months ended June 30, 2008 and 2007, respectively, resulted from merchandising services performed for clients at a leading domestic electronics chain. Services performed for these clients in that electronics chain also accounted for approximately 3% and 10% of the Company's accounts receivable at June 30, 2008 and December 31, 2007, respectively. The Company's contractual relationships or agreements are with various clients and not that retail electronics chain.

One client accounted for 7% and 5% of the Company's net revenues for the six months ended June 30, 2008 and 2007, respectively. The client accounted for approximately 3% of the Company's accounts receivable at both June 30, 2008 and December 31, 2007.

The loss of the ability to provide merchandising and marketing services in the above and/or other chains or the loss of this client or other clients could significantly decrease the Company's revenues and could have a material adverse effect on the Company's business, results of operations and financial condition.



**SPAR Group, Inc.**

**Cost of Revenues**

Cost of revenues consists of in-store labor and field management wages, related benefits, travel and other direct labor-related expenses. Cost of revenues was 72.1% of net revenues for the six months ended June 30, 2008 and 69.0% for the six months ended June 30, 2007. The increase in cost of revenues as a percent of net revenues of 3.1% is primarily a result of international operations.

Internationally, the cost of revenues was 74.2% of net revenues for the six months ended June 30, 2008 and 67.6% of net revenues for the six months ended June 30, 2007. The international cost of revenues percentage increase was primarily attributed to a mix of higher cost margin business in Canada, China and Turkey.

Domestic cost of revenues was 69.4% of net revenues for the six months ended June 30, 2008 and 70.3% of net revenues for the six months ended June 30, 2007. In the first quarter of 2008, SPAR Management Services, Inc. ("SMS"), an affiliate of the Company, forgave \$100,000 of debt owed by the Company for field management expenses. Excluding this transaction, domestic cost of revenue as a percent of net revenues for the six months ending June 30, 2008 was 70.0%, a decrease of (0.3)% compared to the same period in 2007.

Approximately 87% and 84% of the Company's domestic cost of revenues in the six months ended June 30, 2008 and 2007, respectively, resulted from in-store independent contractor and field management services purchased from certain of the Company's affiliates, SPAR Marketing Services, Inc. ("SMS"), and SPAR Management Services, Inc. ("SMSI"), respectively (see Note 6 - Related-Party Transactions).

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses include corporate overhead, project management, information technology, executive compensation, human resources, and legal and accounting expenses. Selling, general and administrative expenses decreased by \$976,000, or 9.6%, for the six months ended June 30, 2008, to \$9.2 million compared to \$10.2 million for the same period in 2007.

International selling, general and administrative expenses totaled \$4.7 million for both the six months ended June 30, 2008 and 2007.

Domestic selling, general and administrative expenses totaled \$4.5 million for the six months ended June 30, 2008, compared to \$5.4 million for the same period in 2007. The decrease in domestic selling, general and administrative expenses of \$919,000 was primarily due to a decrease in salary related expenses of \$357,000, reduced building related expenses of \$163,000 (\$74,000 was related to a one-time charge in 2007 for relocation expenses) and a reduction of \$419,000 in office related expenses (\$211,000 was related to reduced equipment rental expenses).

**Depreciation and Amortization**

Depreciation and amortization charges for the six months ended June 30, 2008, totaled \$429,000 and were comparable to \$391,000 for the same period in 2007.

**Interest Expense**

Interest expense decreased 10.5% to \$162,000 from \$181,000 for the six months ended June 30, 2008 and 2007, respectively. The decrease of 10.5% was primarily due to decreases in interest rates.

**Other Expense**

Other expense totaled \$564,000 and \$38,000 for the six months ended June 30, 2008 and 2007, respectively. Included in other expense for the six months ended June 30, 2008 was approximately \$458,000 for non-recurring legal costs, which was the primary reason for the increase in other expenses over the prior period.





**SPAR Group, Inc.**

**Income Taxes**

Income tax benefit for the six months ended June 30, 2008 was approximately (\$21,000) resulting from a FIN 48 adjustment from international operations.

**Minority Interest**

Minority interest of approximately \$106,000 and \$16,000 resulted from the net operating profits of the Company's 51% owned subsidiaries and 50% owned subsidiaries for the six months ended June 30, 2008 and 2007, respectively.

**Net Loss**

The Company had a net loss of \$247,000 for the six months ended June 30, 2008, or (\$0.01) per share, compared to a net loss of 2.2 million, or \$0.12 per share, for the corresponding period last year.

**SPAR Group, Inc.**

***Liquidity and Capital Resources***

In the six months ended June 30, 2008 the Company had a net loss of \$247,000.

Net cash provided by operating activities for the six months ended June 30, 2008 was \$2.3 million compared to \$3.8 million for the prior year. The decrease in net cash provided by operating activities was primarily due to a decrease in accounts receivable and increase in accounts payable, accrued expenses and other account liabilities.

Net cash used in investing activities for the six months ended June 30, 2008 and June 30, 2007, was approximately \$225,000 and \$429,000, respectively. The decrease in net cash used in investing activities was a result of decreased purchases of property and equipment.

Net cash used in financing activities for the six months ended June 30, 2008 and 2007, was approximately \$1.0 million and \$2.9 million, respectively. The decrease in net cash used in financing activities was primarily a result of reduced net payments on lines of credit.

The above activity resulted in an increase in cash and cash equivalents for the six months ended June 30, 2008, of approximately \$1.0 million.

At June 30, 2008, the Company had negative working capital of \$464,000, as compared to a negative \$449,000 at December 31, 2007. The Company's current ratio was 0.97 at June 30, 2008, and 0.97 at December 31, 2007.

In January 2003, the Company (other than SGRP's foreign subsidiaries) and Webster Business Credit Corporation, then known as Whitehall Business Credit Corporation ("Webster"), entered into the Third Amended and Restated Revolving Credit and Security Agreement (as amended, collectively, the "Credit Facility"). The Credit Facility provides for a \$5.0 million revolving line of credit maturing on January 23, 2009. In March 2007 the credit facility was further amended to, among other things, delay the Minimum Fixed Coverage ratio until the fourth quarter 2007, establish an EBITDA covenant and increase the interest rate by .25% beginning March 28, 2007. In May 2007 the credit facility was amended to provide for an availability reserve of \$500,000. In August 2007 the credit facility was further amended to reduce the availability reserve to \$250,000 until November 30, 2007. On November 16, 2007 Webster amended the credit facility to extend the availability reserve of \$250,000 indefinitely and to reduce the revolving line of credit from \$7.0 to \$5.0 million. In February 2008 the Credit Facility was amended to establish monthly EBITDA covenants until September 30, 2008 and to set a Fixed Charged Coverage Ratio covenant for the year ended December 31, 2008. Borrowings are based upon a borrowing base formula as defined in the agreement (principally 85% of "eligible" domestic accounts receivable less certain reserves). The Credit Facility is secured by all of the assets of the Company and its domestic subsidiaries. The Credit Facility also limits certain expenditures, including, but not limited to, capital expenditures and other investments. In addition, Mr. Robert G. Brown, a Director, the Chairman and a major stockholder of SGRP, and Mr. William H. Bartels, a Director, the Vice Chairman and a major stockholder of SGRP, have provided personal guarantees of the Credit Facility totaling \$1.0 million.

The basic interest rate under the Credit Facility is Webster's "Alternative Base Rate" plus 1.0% per annum (a total of 6.0% per annum at June 30, 2008), which automatically changes with each change made by Webster in such Alternative Base Rate. The Company at its option, subject to certain conditions, may elect to have portions of its loans under the Credit Facility bear interest at various LIBOR rates plus 3.25% per annum based on fixed interest periods of one, two, three or nine months. The actual average interest rate under the Credit Facility was 6.57% per annum for the six months ended June 30, 2008.

The domestic revolving loan balances outstanding under the Credit Facility were \$3.9 million and \$4.9 million at June 30, 2008 and December 31, 2007, respectively. As of June 30, 2008, the SPAR Group had unused availability under the Credit Facility of \$44,000 out of the remaining maximum \$1.1 million unused revolving line of credit after reducing the borrowing base by outstanding loans.

**SPAR Group, Inc.**

Because of the requirement to maintain a lock box arrangement with Webster and Webster's ability to invoke a subjective acceleration clause at its discretion, borrowings under the Credit Facility are classified as current at June 30, 2008 and December 31, 2007, in accordance with EITF 95-22, Balance Sheet Classification of Borrowings Outstanding Under Revolving Credit Agreements That Include Both a Subjective Acceleration Clause and a Lock-Box agreement.

The Company was in violation of its April 2008 covenant (and has received a waiver from Webster). The Company was not in violation as of June 30, 2008, and does not expect to be in violation at future measurement dates. However, there are no assurances that the Company will not be in violation of certain covenants in the future. Should the Company be in violation, there are no assurances that Webster will issue waivers for any future violations.

The Japanese subsidiary, SPAR FM Japan, Inc., has line of credit agreements totaling 100 million Yen, or approximately \$948,000 (based upon the exchange rate at June 30, 2008). The outstanding balances under the line of credit agreements were 50 million Yen, or \$474,000 at June 30, 2008 and 90 million Yen, or \$802,000 at December 31, 2007 (based upon the exchange rate at those dates). The average interest rate was 2.45% per annum for the six months ended June 30, 2008. In addition, the Japan subsidiary had cash balances totaling 191 million Yen, or approximately \$1.8 million and 137 million Yen, or approximately \$1.2 million at June 30, 2008 and December 31, 2007 respectively (based upon the exchange rates at those dates).

The Australian subsidiary, SPARFACTS Australia Pty. Ltd., has a revolving line of credit arrangement with Oxford Funding Pty. Ltd. for \$1.1 million (Australian) or approximately \$1.0 million (based upon the exchange rate at June 30, 2008). The outstanding balances under the line of credit agreements were \$268,000 (Australian), or \$249,000 at June 30, 2008 and a balance of \$315,000 (Australian) or \$276,000 at December 31, 2007 (based upon the exchange rate at those dates). The average interest rate was 12.7% per annum for the six months ended June 30, 2008.

SPAR Canada Company, a wholly owned subsidiary, has a credit agreement with Royal Bank of Canada providing for a Demand Operating Loan for a maximum borrowing of \$750,000 (Canadian), or \$743,000 (based upon the exchange rate at June 30, 2008). The Demand Operating Loan provides for borrowings based upon a borrowing base formula as defined in the agreement (principally 75% of eligible accounts receivable less certain deductions). The outstanding balances under the line of credit agreement were \$500,000 (Canadian), or \$495,000 and \$140,000 (Canadian), or \$143,000 at June 30, 2008 and December 31, 2007, respectively (based upon the exchange rate at those dates). The average interest rate was 5.75% per annum for the six months ended June 30, 2008.

The Company's international business model is to partner with local merchandising companies and combine the Company's proprietary software and expertise in the merchandising and marketing services business with their partner's knowledge of the local market. In 2001, the Company established its first subsidiary in Japan and has continued this strategy. As of this filing, the Company is currently operating in 13 countries and has 9 international subsidiaries. Certain of these subsidiaries are profitable, while others are operating at a loss. In the event of continued losses, the Company may be required to provide additional cash infusions into those subsidiaries with losses.

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

The Company's Credit Facility with Webster is scheduled for renewal in late January 2009, as noted above. While management believes that Webster will renew the Credit facility with the Company, there are no assurances that Webster will in fact renew the Credit Facility at that time or that the Company would be able to obtain alternative financing on acceptable terms.

## SPAR Group, Inc.

## Certain Contractual Obligations

The following table contains a summary of certain of the Company's contractual obligations by category as of June 30, 2008 (in thousands):

| Contractual Obligations     | Period in which payments are due |                  |                 |               |                   |
|-----------------------------|----------------------------------|------------------|-----------------|---------------|-------------------|
|                             | Total                            | Less than 1 year | 1-3 years       | 3-5 years     | More than 5 years |
| Credit Facilities           | \$ 5,129                         | \$ 5,129         | \$ —            | \$ —          | \$ —              |
| Capital Lease Obligations   | 431                              | 223              | 208             | —             | —                 |
| Operating Lease Obligations | 3,978                            | 826              | 2,313           | 839           | —                 |
| <b>Total</b>                | <b>\$ 9,538</b>                  | <b>\$ 6,178</b>  | <b>\$ 2,521</b> | <b>\$ 839</b> | <b>\$ —</b>       |

## 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. At June 30, 2008, the Company's outstanding lines of credit totaled \$5.1 million, as noted in the table below (in thousands):

| Location      | Variable Interest Rate (1) | Local Currency Amount | US Dollars Equivalent (2) |
|---------------|----------------------------|-----------------------|---------------------------|
| United States | 6.00%                      | 3,911 USD             | \$ 3,911                  |
| Japan         | 2.45%                      | 50,000 YEN            | 474                       |
| Australia     | 12.7%                      | 268 AUD               | 249                       |
| Canada        | 5.75%                      | 500 CAD               | 495                       |
|               |                            |                       | \$ 5,129                  |

(1) Based on interest rate at June 30, 2008.

(2) Based on exchange rate at June 30, 2008.

Based on the 2008 average outstanding borrowings under variable-rate debt, a one-percentage point increase in interest rates would negatively impact pre-tax earnings and cash flows for the six months ended June 30, 2008 by approximately \$28,000.

The Company has foreign currency exposure with its international subsidiaries. In both 2008 and 2007, these exposures are primarily concentrated in the Canadian Dollar, Australian Dollar and Japanese Yen. At June 30, 2008, international assets totaled \$9.8 million and international liabilities totaled \$13.8 million. International revenues for the six months ended June 30, 2008 and 2007 were \$20 million and \$13.6 million, respectively. The international division reported a net income (loss) of approximately \$257,000 and (\$508,000) for the six months ended June 30, 2008 and 2007, respectively.



**SPAR Group, Inc.**

In those countries where the Company had the greater risk for foreign currency exposure, the total assets and liabilities are as follows (in thousands) in U.S. Dollars based on the June 30, 2008, exchange rates:

| Country   | Total Assets | Total Liabilities |
|-----------|--------------|-------------------|
| Canada    | \$ 1,452     | \$ 783            |
| Australia | 1,779        | 1,219             |
| Japan     | 3,175        | 2,748             |

**Item 4. Controls and Procedures**

The Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) as of the end of the period covering this report. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's rules and forms.

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

The Company has established a plan, documented and tested its domestic internal controls over financial reporting required by Section 404 of the Sarbanes-Oxley Act of 2002 and has developed a plan to document and test its internal controls as they pertain to its material international subsidiaries.

SPAR Group, Inc.

**PART II: OTHER INFORMATION**

**Item 1. Legal Proceedings**

Safeway Inc. ("Safeway") filed a Complaint against PIA Merchandising Co., Inc. ("PIA Co."), a wholly owned subsidiary of SPAR Group, Inc. ("SGRP"), Pivotal Sales Company ("Pivotal"), a wholly owned subsidiary of PIA Co., and SGRP in Alameda Superior Court, case no. 2001028498 on October 24, 2001. Safeway claims, as subsequently amended, alleged causes of action for breach of contract and breach of implied contract. PIA Co. and Pivotal filed cross-claims against Safeway on or about March 11, 2002, and amended them on or about October 15, 2002, alleging causes of action by PIA Co. and Pivotal against Safeway for breach of contract, interference with economic relationship, unfair trade practices and unjust enrichment. Trial commenced in March 2006.

On May 26, 2006, the jury in this case returned a verdict resulting in a net award of \$1,307,700 to Pivotal, a SGRP subsidiary. This net award is to be paid by Safeway and resulted from separate jury findings that awarded damages to those SGRP subsidiaries on certain claims and damages to Safeway on other claims. In particular, the jury awarded damages to Pivotal of \$5,760,879 for Safeway's interference with Pivotal's contractual relationships with third party manufacturers and also awarded \$782,400 to Pivotal and PIA for Safeway's breach of contract with those SGRP subsidiaries. The jury awarded damages to Safeway of \$5,235,579 for breach of contract by SGRP and those SGRP subsidiaries. Judgment was entered in favor of Pivotal on August 14, 2006 for \$1,307,700. Both sides filed post trial motions but all post trial motions were denied. Notices of Appeal were thereafter filed by both Safeway and Pivotal/PIA/SGRP. Pivotal/PIA/SGRP is seeking to have Safeway's award overturned, thereby increasing the award to Pivotal by over \$5 million. Safeway is seeking to have overturned the \$5,760,879 award against it for interference with contractual relationships. With the appeals pending, the parties participated in a mediation of the dispute, but it was not successful in resolving the matter. Accordingly, the appeals are proceeding.

Briefing on the appeals commenced in the second quarter of 2008, it is expected that opposition and reply briefs will be completed by March 2009. Thereafter, an oral argument hearing date will be assigned by the court of appeal. The appellate process in the California Court of Appeal is expected to last until late 2009. The Company has recorded the net \$1.3 million judgment award in other assets.

In addition to the above, the Company is a party to various other legal actions and administrative proceedings arising in the normal course of business. In the opinion of Company's management, disposition of these other matters are not anticipated to have a material adverse effect on the financial position, results of operations or cash flows of the Company.

**Item 1A. Risk Factors**

The Company's Annual Report for 2007 on Form 10-K describes various risk factors applicable to the Company and its businesses in Item 1 under the caption "Certain Risk Factors", which risk factors are incorporated by reference into this Quarterly Report. There have been no material changes in the Company's risk factors since the Company's Annual Report for 2007 on Form 10-K.

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

Item 2(a): Not applicable

Item 2(b): Not applicable

Item 2(c): Not applicable



**SPAR Group, Inc.****Item 3. Defaults upon Senior Securities**

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

Item 3(b): Defaults under Preferred Stock: Not applicable.

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

SGRP held its Annual Meeting of Stockholders on May 29, 2008. The meeting was held (1) to elect the Board of Directors, (2) to ratify the appointment of Rehmann Robson, P.C. as the Company's independent auditors for the year ending December 31, 2008 and (3) to approve the 2008 Stock Compensation Plan.

Proposal Number 1 – Election of Directors:

| Name:              | For:       | Abstention: |
|--------------------|------------|-------------|
| Gary S. Raymond    | 18,267,323 | 122,748     |
| Robert G. Brown    | 18,219,423 | 170,648     |
| William H. Bartels | 18,219,923 | 170,148     |
| Jack W. Partridge  | 17,014,812 | 1,375,259   |
| Jerry B. Gilbert   | 18,241,599 | 148,472     |
| Lorrence T. Kellar | 18,241,299 | 148,772     |
| C. Manly Molpus    | 18,239,799 | 150,272     |

Each of the nominees was elected to the Board of Directors of SGRP.

Proposal Number 2 – Ratification of the appointment of Rehmann Robson, P.C. as the Company's independent public accountant for the fiscal year ending December 31, 2008:

| For:       | Against: | Abstention: |
|------------|----------|-------------|
| 18,289,673 | 65,802   | 34,596      |

Proposal Number 3 – Approval of the 2008 Stock Compensation Plan:

| For:       | Against: | Abstention: |
|------------|----------|-------------|
| 15,811,943 | 286,026  | 15,760      |

**Item 5. Other Information**

Not applicable.

**Item 6. Exhibits**

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- 10.1 Waiver And Amendment No. 13 To Third Amended And Restated Revolving Credit And Security Agreement among Webster Business Credit Corporation, SPAR Group, Inc., and certain of its subsidiaries dated as of August 14, 2008 with respect to the fiscal quarter ended June 30, 2008 (as filed herewith).
- 31.1 Certification of the CEO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as filed herewith.
- 31.2 Certification of the CFO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as filed herewith.
- 32.1 Certification of the CEO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as filed herewith.
- 32.2 Certification of the CFO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as filed herewith.

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**SPAR Group, Inc.**

**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 14, 2008

SPAR Group, Inc., Registrant

By: /s/ James R. Segreto

James R. Segreto

Chief Financial Officer, Treasurer, Secretary

and duly authorized signatory