

SPAR GROUP INC
Form 10-K
April 15, 2009
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the fiscal year ended **December 31, 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 or other jurisdiction of incorporation or organization)

33-0684451
(I.R.S. Employer Identification No.)

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

10591
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: Common Stock, par value \$.01 per share

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

Indicate by check mark 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 twelve months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K .

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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 definition of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act.). (Check one):

Large Accelerated Filer <input type="radio"/>	Accelerated Filer <input type="radio"/>
Non-Accelerated Filer <input checked="" type="radio"/>	Smaller reporting company <input checked="" type="radio"/>

(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

The aggregate market value of the Common Stock of the Registrant held by non-affiliates of the Registrant on June 30, 2008, based on the closing price of the Common Stock as reported by the Nasdaq Capital Market on such date, was approximately \$3,700,000.

The number of shares of the Registrant's Common Stock outstanding as of December 31, 2008, was 19,139,365 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of our fiscal year, for our Annual Meeting of Shareholders, presently scheduled to be held on May 28, 2009, are incorporated by reference into Part III of this Form 10-K.

SPAR GROUP, INC.

ANNUAL REPORT ON FORM 10-K

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PART I

Statements contained in this Annual Report on Form 10-K of SPAR Group, Inc. (“SGRP”, and together with its subsidiaries, the “SPAR Group” or the “Company”), include “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”, and together with the Securities Act, the “Securities Laws”), including, in particular and without limitation, the statements contained in the discussions under the headings “Business”, “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”. 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”, “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.

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. You should carefully review the risk factors described below (see Item 1A – Risk Factors) and any other cautionary statements contained in this Annual Report on Form 10-K. All forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified by all such risk factors and other cautionary statements. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Item 1. Business

GENERAL

The SPAR Group, Inc., a Delaware corporation (“SGRP”), and its subsidiaries (together with SGRP, the “SPAR Group” or the “Company”), is a supplier of merchandising and other marketing services throughout the United States and internationally. 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, Radio Frequency Identification (“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, marketing services and in-store event staffing 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.

Merchandising 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 primarily under single or multi-year contracts or agreements. 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, and include new store openings, new product launches, special seasonal or promotional merchandising, focused product support and product recalls.

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, convenience and grocery stores. Included in its clients are home

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entertainment, general merchandise, health and beauty care, consumer goods and food products companies in the United States.

International Merchandising Services Division

In July 2000, the Company established its International Merchandising Services Division to focus on expanding its merchandising and other marketing services business worldwide. The Company has expanded its international business as follows:

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

INDUSTRY OVERVIEW

Domestic Merchandising Services Division

According to industry estimates over two billion dollars is spent annually on domestic retail merchandising and marketing services. The merchandising and marketing services industry includes manufacturers, retailers, food brokers, and professional service merchandising companies. The Company believes there is a continuing trend for major retailers and manufacturers to move toward third parties to handle in-store merchandising. The Company also believes that its merchandising and marketing services bring added value to retailers, manufacturers and other businesses. Retail merchandising and marketing services enhance sales by making a product more visible and available to consumers. These services primarily include placing orders, shelf maintenance, display placement, reconfiguring products on store shelves and replenishing product inventory. The Company provides other marketing services such as test market research, mystery shopping, and promotion planning and analysis.

The Company believes merchandising and marketing services previously undertaken by retailers and manufacturers have continued to be outsourced to third parties. Historically, retailers staffed their stores as needed to ensure inventory levels, the advantageous display of new items on shelves, and the maintenance of shelf schematics. In an effort to improve their margins, retailers decreased their own store personnel and increased their reliance on manufacturers to perform such services. Initially, manufacturers attempted to satisfy the need for merchandising and marketing services in retail stores by utilizing their own sales representatives. Retailers also used their employees to merchandise their stores. However, both the manufacturers and the retailers discovered that using their own sales representatives and employees for this purpose was expensive and inefficient. Therefore, manufacturers and retailers have continued to outsource the merchandising and marketing services to third parties capable of operating at a lower cost by (among other things) serving multiple manufacturers simultaneously.

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

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

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International Merchandising Services Division

The Company believes another current trend in business is globalization. As companies expand into foreign markets they will need assistance in merchandising or marketing their products. As evidenced in the United States, retailer and manufacturer sponsored merchandising and marketing programs are both expensive and inefficient. The Company also believes that the difficulties encountered by these programs are only exacerbated by the logistics of operating in foreign markets. This environment has created an opportunity for the Company to exploit its Internet-based technology and business model that are successful in the United States.

In July 2000, the Company established its International Merchandising Services Division to cultivate foreign markets, modify the necessary systems and implement the Company's business model worldwide by expanding its merchandising and marketing services business off shore. The Company formed an International Merchandising Services Division task force consisting of members of the Company's information technology, operations and finance groups to evaluate and develop foreign markets.

Key to the Company's international strategy is the translation of several of its proprietary Internet-based logistical, communications and reporting software applications into the native language of any market the Company enters. As a result of this requirement for market penetration, the Company has developed translation software that can quickly convert its proprietary software into various languages. Through its computer facilities in Auburn Hills, Michigan, the Company provides worldwide access to its proprietary logistical, communications and reporting software. In addition, the Company maintains personnel in Greece and Australia to assist in its international efforts. Today the Company operates in 13 countries whose population represents approximately 48% of the total world population and is actively pursuing expansion into various other markets.

Another key to the Company's international strategy is seeking a material investment and participation in an international subsidiary by an experienced person or company in the local country not otherwise affiliated with the Company (each a "Local Owner"). The Company generally seeks to own at least 51% of a foreign subsidiary, although it owns 50% of the equity interests in the Company's subsidiaries in Japan and China. Canada is the only international subsidiary wholly-owned by the Company. Local Owners provide equity, credit support and certain services and generally are or provide management support for the corresponding international subsidiaries. (See Item 1A - Risks of Having Material Local Investors in International Subsidiaries, below).

Financial Information About Geographic and Business Segments

The Company operates both domestically and internationally in the two distinct geographic/business segments described above. Certain financial information regarding the Company's geographic and business segments, which includes net revenues and operating income (loss) for each of the years ended December 31, 2008, and December 31, 2007, and long-lived assets as of December 31, 2008, and December 31, 2007, is provided in Note 11 to the Company's Consolidated Financial Statements herein.

BUSINESS STRATEGY

As the marketing services industry continues to expand both in the United States and internationally, large retailers and manufacturers are outsourcing their merchandising and marketing service needs to third-party providers. The Company believes that offering marketing services on a national and global basis will provide it with a competitive advantage. Moreover, the Company believes that successful use of and continuous improvements to a sophisticated technology infrastructure, including its proprietary Internet-based software, is key to providing clients with a high level of client service while maintaining efficient, low cost operations. The Company's objective is to become an international retail merchandising and marketing service provider by pursuing its operating and growth strategy, as described below.

Increased Sales Efforts:

The Company is seeking to increase revenues by increasing sales to its current clients, as well as, establishing long-term relationships with new clients, many of which currently use other merchandising companies for various reasons. The Company believes its technology, field implementation and other competitive advantages will allow it to capture a larger share of this market over time. However, there can be no assurance that any increased sales will be achieved.

New Products:

The Company is seeking to increase revenues through the internal development and implementation of new products and services that add value to its clients' retail merchandising related activities, some of which have been identified and are currently being tested for feasibility and market acceptance. However, there can be no assurance that any new products of value will be developed or that any such new product can be successfully marketed.

Acquisitions:

The Company is seeking to acquire businesses or enter into partnerships, joint ventures or other arrangements with companies that offer similar merchandising or marketing services both in the United States and worldwide. The Company believes that increasing its industry expertise, adding product segments, and increasing its geographic breadth will allow it to service its clients more efficiently and cost effectively. Through such acquisitions, the Company may realize additional operating and revenue synergies and may leverage existing relationships with manufacturers, retailers and other businesses to create cross-selling opportunities. However, there can be no assurance that any of the acquisitions will occur or whether, if completed, the integration of the acquired businesses will be successful or the anticipated efficiencies and cross-selling opportunities will occur.

Leverage and Improve Technology:

The Company believes that providing merchandising and marketing services in a timely, accurate and efficient manner, as well as delivering timely, accurate and useful reports to its clients, are key components that are and will continue to be critical to the Company's success. The Company has developed Internet-based logistic deployment, communications, and reporting systems that improve the productivity of its merchandising specialists and provide timely data to its clients. The Company's merchandising specialists use hand-held computers, personal computers or laptop computers to report the status of each store or client product they service. Merchandising specialists report on a variety of issues such as store conditions, status of client products (e.g. out of stocks, inventory, display placement) or they may scan and process new orders for certain products.

Through the Company's automated labor tracking system, its merchandising specialists communicate work assignment completion information via the Internet, cellular telephone or landlines, enabling the Company to report hours and other completion information for each work assignment on a daily basis and providing the Company with daily, detailed tracking of work completion. This information is analyzed and displayed in a variety of reports that can be accessed by both the Company and its clients via the Internet. These reports can depict the status of merchandising projects in real time. This technology also allows the Company to schedule its merchandising specialists more efficiently, quickly quantify the benefits of its services to clients, rapidly respond to clients' needs and rapidly implement programs.

The Company intends to continue to utilize computer (including hand-held computers), Internet, cellular telephone and other technology to enhance its efficiency and ability to provide real-time data to its clients, as well as, maximize the speed of communication, and logistical deployment of its merchandising specialists. Industry sources indicate that clients are increasingly relying on merchandising and marketing service providers to supply rapid, value-added information regarding the results of merchandising and marketing expenditures on sales and profits. The Company (together with certain of its affiliates) has developed and owns proprietary Internet-based software technology that allows it to utilize the Internet to communicate with its field management, schedule its store-specific field operations more efficiently, receive information and incorporate the data immediately, quantify the benefits of its services to clients faster, respond to clients' needs quickly and implement client programs rapidly. The Company has successfully modified and is currently utilizing certain of its software applications in connection with its international ventures.

The Company believes that it can continue to improve, modify and adapt its technology to support merchandising and other marketing services for additional clients and projects in the United States and in foreign markets. The Company also believes that its proprietary Internet-based software technology gives it a competitive advantage in the marketplace.

Improve Operating Efficiencies:

The Company will continue to seek greater operating efficiencies. The Company believes that its existing field force and technology infrastructure can support additional clients and revenue in both its Domestic Merchandising Services Division and International Merchandising Services Division.

DESCRIPTION OF SERVICES

The Company currently provides a broad array of merchandising and marketing services to some of the world's leading companies, both domestically and internationally. The Company believes its full-line capabilities provide fully integrated solutions that distinguish the Company from its competitors. These capabilities include the ability to develop plans at one centralized location, effect chain wide execution, implement rapid, coordinated responses to its clients' needs and report on a real time Internet enhanced basis. The Company also believes its international presence, industry-leading technology, centralized decision-making ability, local follow-through, ability to recruit, train and supervise merchandisers, ability to perform large-scale initiatives on short notice, and strong retailer relationships provide the Company with a significant advantage over local, regional or other competitors.

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, 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, convenience and grocery stores. The International Merchandising Services Division established in July 2000, currently provides similar merchandising, marketing services and in-store event staffing through subsidiaries in Japan, Canada, Turkey, South Africa, India, Romania, China, Lithuania, Latvia, Estonia, Australia and New Zealand. Today the Company operates in 13 countries whose population represents approximately 48% of the total world population.

The Company provides its merchandising and marketing services primarily on behalf of retailers and consumer product manufacturers and distributors at mass merchandiser, electronic, drug and retail grocery chains. The Company currently provides three principal types of merchandising and marketing services: syndicated services, dedicated services and project services.

Syndicated Services

Syndicated services consist of regularly scheduled, routed merchandising and marketing services provided at the retail store level for various manufacturers and distributors. These services are performed for multiple manufacturers and distributors, including, in some cases, manufacturers and distributors whose products are in the same product category. Syndicated services may include activities such as:

- Reordering and replenishment of products
- Ensuring that the clients' products authorized for distribution are in stock and on the shelf
- Adding new products that are approved for distribution but not yet present on the shelf
- Designing and implementing store planogram schematics
- Setting product category shelves in accordance with approved store schematics
- Ensuring that product shelf tags are in place
- Checking for overall salability of the clients' products
- Placing new product and promotional items in prominent positions

Dedicated Services

Dedicated services consist of merchandising and marketing services, generally as described above, which are performed for a specific retailer or manufacturer by a dedicated organization, including a management team working exclusively for that retailer or manufacturer. These services include many of the above activities detailed in syndicated services, as well as, new store set-ups, store remodels and fixture installations. These services are primarily based on agreed-upon rates and fixed management fees.

Project Services

Project services consist primarily of specific in-store services initiated by retailers and manufacturers, such as new store openings, new product launches, special seasonal or promotional merchandising, focused product support, product recalls, in-store product demonstrations and in-store product sampling. The Company also performs other project services, such as new store sets and existing store resets, re-merchandising, remodels and category implementations, under annual or stand-alone project contracts or agreements.

In-Store Event Staffing Services

The Company provides in-store product samplings and in-store product demonstrations to national chains in target markets worldwide. The Company has also developed additional product offerings in an effort to expand this segment of its business.

Other Marketing Services

Other marketing services performed by the Company include:

Test Market Research - Testing promotion alternatives, new products and advertising campaigns, as well as packaging, pricing, and location changes, at the store level.

Mystery Shopping - Calling anonymously on retail outlets (e.g. stores, restaurants, banks) to check on distribution or display of a brand and to evaluate products, service of personnel, conditions of store, etc.

Data Collection - Gathering sales and other information systematically for analysis and interpretation.

RFID - Utilizing technology to track merchandiser performance, product inventory at store level as well as other related merchandising and marketing applications.

SALES AND MARKETING

The Company's sales efforts within its Domestic Merchandising Services Division are structured to develop new business in national, regional and local markets. The Company's corporate business development team directs its efforts toward the senior management of prospective clients. Sales strategies developed at the Company's headquarters are communicated to the Company's sales force for execution. The sales force, located nationwide, work from both Company and in home offices. In addition, the Company's corporate account executives play an important role in the Company's new business development efforts within its existing manufacturer, distributor and retailer client base.

As part of the retailer consolidation, retailers are centralizing most administrative functions, including operations, procurement and category management. In response to this centralization and the growing importance of large retailers, many manufacturers have reorganized their selling organizations around a retailer team concept that focuses on a particular retailer. The Company has responded to this emerging trend and currently has retailer teams in place at select retailers.

The Company's business development process includes a due diligence period to determine the objectives of the prospective client, the work required to satisfy those objectives and the market value of such work to be performed. The Company employs a formal cost development and proposal process that determines the cost of each element of work required to achieve the prospective client's objectives. These costs, together with an analysis of market rates, are used in the development of a formal quotation that is then reviewed at various levels within the organization. The pricing of this internal proposal must meet the Company's objectives for profitability, which are established as part of the business planning process. After approval of this quotation, a detailed proposal is presented to the prospective client.

The Company's marketing efforts within its International Merchandising Services Division are three fold. First, the Company endeavors to develop new markets through acquisitions. The Company's international acquisition team, whose primary focus is to seek out and develop acquisitions throughout the world, consists of personnel located in the United States, Greece and Australia. Personnel from information technology, field operations, client services and finance support the international acquisition team. Second, the Company offers global merchandising solutions to clients that have worldwide distribution. This effort is spearheaded out of the Company's headquarters in the United States. Third, the Company develops local markets through various subsidiaries throughout the world.

CUSTOMER BASE

The Company currently represents numerous manufacturers and /or retail clients in a wide range of retail chains and stores worldwide, including:

- Mass Merchandisers
- Electronics
- Drug
- Grocery
- Other retail outlets (such as discount stores, home and office supply centers, etc.)

One customer accounted for 11% and 6% of the Company's net revenues for the years ended December 31, 2008, and 2007, respectively. This customer accounted for approximately 4% and 7% of the Company's accounts receivable at December 31, 2008, and 2007, respectively.

A second customer accounted for 7% of the Company's net revenues for both the years ended December 31, 2008, and 2007. This customer accounted for approximately 3% of the Company's accounts receivable at December 31, 2008, and 2007.

In addition, approximately 5% and 7% of the Company's net revenues for the years ended December 31, 2008, and 2007, respectively, resulted from merchandising services performed for manufacturers and others in stores operated by a leading mass merchandising chain in the United States. These customers accounted for approximately 4% and 5% of the Company's accounts receivable at December 31, 2008, and 2007, respectively.

Also, approximately 9% and 14% of the Company's net revenues for the years ended December 31, 2008, and 2007, respectively, resulted from merchandising services performed for manufacturers and others in stores operated by Circuit City Stores, Inc. ("Circuit City"), which until recently was a leading electronics chain in the United States. Services performed for those clients in Circuit City also accounted for 7% and 10% of Company's accounts receivable at December 31, 2008, and 2007, respectively. Circuit City closed a number of stores in 2008 and filed for protection under the U.S. Bankruptcy Code on November 10, 2008. On January 17, 2009, Circuit City began the complete liquidation of all of its inventory. Its liquidation sales are scheduled to continue through March 31, 2009, following which it is currently scheduled to close all of its stores. At December 31, 2008, Circuit City owed the Company approximately \$245,000 in unpaid (pre-bankruptcy) receivables.

While the Company's contractual relationships or agreements are for the most part with various clients and not directly with Circuit City, the closing of this retailer's stores will result in a significant decrease in the Company's 2009 revenues and could have a material adverse effect on the Company's business, results of operations and financial condition. In addition, the failure to attract new business in other retailers could significantly impede the growth of the Company's revenues, which could have a material adverse effect on the Company's future business, results of operations and financial condition.

COMPETITION

The marketing services industry is highly competitive. The Company's competition in the Domestic and International Merchandising Services Division