

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

Amendment No. 2

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the year ended January 1, 1999

Commission file number 0-27824

PIA MERCHANDISING SERVICES, INC.

Delaware 33-0684451  
(State or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or organization)

19900 MACARTHUR BLVD, SUITE 900, IRVINE, CA 92612  
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (949) 476-2200

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

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

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 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 [X]

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. [ ]

The aggregate market value of the Common Stock of the Registrant held by  
non-affiliates of the Registrant on May 1, 1999, based on the closing price of  
the Common Stock as reported by the Nasdaq National Market on such date, was  
approximately \$4,031,301.

The number of shares of the Registrant's Common Stock outstanding as of  
May 1, 1999 was 5,480,966 shares.

DOCUMENTS INCORPORATED BY REFERENCE

None.

PIA MERCHANDISING SERVICES, INC.

ANNUAL REPORT ON FORM 10-K/A

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PART I

THIS ANNUAL REPORT ON FORM 10-K/A INCLUDES "FORWARD-LOOKING STATEMENTS" WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT AND SECTION 21E OF THE EXCHANGE ACT INCLUDING, IN PARTICULAR, THE STATEMENTS ABOUT PIA'S PLANS AND STRATEGIES UNDER THE HEADINGS "BUSINESS" AND "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS." ALTHOUGH PIA BELIEVES THAT ITS PLANS, INTENTIONS AND EXPECTATIONS REFLECTED IN OR SUGGESTED BY SUCH FORWARD-LOOKING STATEMENTS ARE REASONABLE, IT CANNOT ASSURE THAT SUCH PLANS, INTENTIONS OR EXPECTATIONS WILL BE ACHIEVED. IMPORTANT FACTORS THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THE FORWARD-LOOKING STATEMENTS MADE IN THIS ANNUAL REPORT ON FORM 10-K/A ARE SET FORTH UNDER THE HEADING "RISK FACTORS" AND ELSEWHERE IN THIS ANNUAL REPORT ON FORM 10-K/A. ALL FORWARD-LOOKING STATEMENTS ATTRIBUTABLE TO PIA OR PERSONS ACTING ON ITS BEHALF ARE EXPRESSLY QUALIFIED BY THE CAUTIONARY STATEMENTS CONTAINED IN THIS ANNUAL REPORT ON FORM 10-K/A.

SEE THE GLOSSARY AT PAGE 13 FOR A DESCRIPTION OF CERTAIN TERMS THAT ARE USED THROUGHOUT THIS ANNUAL REPORT ON FORM 10-K/A.

ITEM 1. BUSINESS

GENERAL

PIA Merchandising Services, Inc. ("PIA" or the "Company") is a supplier of in-store merchandising and sales services in the United States and Canada. The Company provides these services primarily on behalf of consumer product manufacturers, consumer service companies and retailers at approximately 17,000 retail grocery stores, 6,000 mass merchandiser and 8,800 drug stores.

The Company currently provides three principal types of services: shared services, where an associate represents multiple clients; dedicated services, where associates work for one specific client; and project services, where associates perform specified in-store activities.

Shared services consist of regularly scheduled, routed merchandising services provided at the stores for multiple manufacturers, primarily under multi-year contracts. Shared services may include activities such as: ensuring that client's products authorized for distribution are in stock and on the shelf, adding in new products that are approved for distribution but not present 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 clients' products and selling new product and promotional items.

In 1998, PIA developed a new strategy for routed merchandising services. The stores are selected for routed merchandising services based on two sets of criteria. The first is the store's weekly All Commodity Volume ("ACV"). The higher the sales volume of a store, the greater the need for merchandising services and more frequent visits to the store are required. The second criterion is based on retailer discipline. This is a subjective determination and therefore based on retail conditions, schematic discipline and competitive activity. This new market strategy provides our clients with an added focused approach to meeting their merchandising needs.

Dedicated services generally consist of merchandising services as described above except that dedicated services are performed for a specific retailer or manufacturer by a dedicated organization. The merchandisers and management team work exclusively for that retailer or manufacturer. These services are normally provided under multi-year contracts.

For both shared service clients and dedicated service clients, the Company

also performs project services. Project services consist primarily of specific in-store services initiated by retailers and manufacturers, such as new product launches, special seasonal or promotional merchandising, focused product support and product recalls. These services typically are used for large-scale implementations over 30 days. The Company also performs other project services, such as new store sets and existing store resets, re-merchandising, remodels and category implementations, under shared service contracts or stand-alone project contracts.

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As part of its shared and dedicated services, PIA also collects and provides to certain clients a variety of merchandising data that is category, product and store specific.

PIA, organized in 1943, initially provided merchandising services in grocery retail chains on behalf of manufacturers. In mid-1988, it was determined that a national merchandising company could capitalize on developments within the retail grocery industry by providing merchandising services to a variety of manufacturers in the industry. Until 1989, the Company operated exclusively in grocery retail chains in California and Arizona. In 1990, PIA implemented a national expansion strategy to cover the grocery trade. In 1993, the Company expanded to address additional retail channels, including mass merchandiser, chain drug and discount drug stores. In 1994, PIA began offering dedicated services to retailers and manufacturers. In 1997, the Company established a corporate and division infrastructure for its project services business. The Company currently performs its services primarily on behalf of approximately 805 consumer product manufacturers.

#### INDUSTRY OVERVIEW

A number of trends have impacted the retail industry and have created a demand for providers of third party merchandising services such as those offered by the Company.

#### SHIFT OF MERCHANDISING SERVICES

Historically, employees of retailers, consumer product manufacturers and food brokers principally performed merchandising functions. Retailers staffed their stores as needed to ensure in-stock conditions, the placement of new items on shelves, and the maintenance of shelf schematics to approved standards. Manufacturers typically deployed their own sales people in an effort to ensure that their products were in distribution and properly positioned on the shelves. However, the primary function of these sales people was to sell the manufacturers' products and promotions, and not to perform significant in-store services at the shelf level. In addition, food brokers performed retail merchandise services on behalf of the manufacturer in conjunction with their sales efforts. Brokers also often performed work at the shelf level at the request of the retailer and their principal client, the manufacturer.

The average grocery store carries approximately 22,000 items. In an effort to maintain or improve their margins, grocery retailers have broadened their product offerings and services from traditional grocery, household and health and beauty care products to include new product categories such as general merchandise and service departments such as bakery, deli and prepared fast foods. The Company believes that, as a result, these retailers have shifted employee hours away from the traditional maintenance of packaged goods in order to support these new categories and service departments. The Company further believes retailers have converted many hours of basic merchandising work from full-time professionals to part-time labor, who are generally less skilled and trained. These trends have caused poorer shelf conditions and an increasing number of out-of-stock items, resulting in lost sales. As a result, retailers are increasingly relying on manufacturers and food brokers, among others, to support their in-store needs such as new store sets and existing store resets, re-merchandising, remodels and category implementations. Initially, manufacturers deployed their sales professionals to perform these retailer-mandated services. However, manufacturers found the deployment of sales professionals to perform retail-merchandising services were expensive and not an effective use of their resources. As manufacturers' costs to perform these services grew and shelf integrity declined, manufacturers began to outsource these merchandising activities to third parties such as the Company.

The outsourcing trend to third party merchandisers has resulted in an increasing number of organizations providing services to manufacturers and retailers. Certain retailers and manufacturers have chosen to consolidate in order to reduce the number of third parties they have to manage, to achieve consistent execution of their retail merchandising strategies, and to customize the scope of services performed on their behalf.

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#### RETAILER CONSOLIDATION

As retailer-mandated activities have continued to increase in both number and type, with a corresponding increase in the amount of labor required to complete them, manufacturers have increased their use of third party suppliers. For example, additional category implementation activities are required to effect retailers' in-store schematics. Schematics are changing more frequently as the result of a growing number of new product introductions each year. Retailers continue to require numerous resets, re-merchandising, and remodels in response to the increasing number of changes in the product mix. PIA estimates that these activities have doubled over the last five years, so that most stores are currently re-merchandised or remodeled every 24 months. In certain areas of the country and with certain retailers, these activities are conducted annually.

#### INCREASE IN MERCHANDISING SERVICES REQUIRED IN OTHER RETAIL CHANNELS

Unlike the merchandising services performed for grocery retailers, work performed by manufacturers in mass merchandiser, chain drug and other retail formats has historically been much less demanding. In these retail channels, retailers performed most of their own merchandising work. However, the Company believes that as these retailers become more competitive, they are attempting to maintain their margins by requesting more support from the manufacturer community to provide merchandising services similar to those provided to the grocery retailers. These retailers have become increasingly important to manufacturers, causing manufacturers to provide greater retail focus and support to ensure out-of-stock conditions are reduced, authorized items are available, and general product conditions are good. Manufacturers have become particularly sensitive to the requirements of seasonal and promotional activities, which require rapid and effective in-store support in order to maximize sales.

#### INCREASE IN USE OF INFORMATION TECHNOLOGIES

Information technology is playing an increasingly important role in the retail industry, particularly in light of industry initiatives towards efficient consumer response ("ECR") and category management. Retailers and manufacturers have expanded their use of information technology to manage product distribution in stores, item placements on the shelves, and off-shelf displays. In particular, retailers and manufacturers are increasingly looking for causal data (e.g., display, pricing and product adjacency information) that is category and store specific. Both retailers and manufacturers use this information to make decisions regarding ECR category management, shelf management, and new product promotion plans. It also gives retailers the ability to tailor their stores to regional demographics.

#### BUSINESS STRATEGY

PIA believes the increasing demand for national solutions to manufacturers' diverse merchandising requirements, together with the consolidation of the retail industry, has increased the growth of outsourcing. The increase in required merchandising services, and the increased use of information technology, will foster the growth of those companies that can provide these solutions, have the flexibility to respond to the changing retail environment and have the financial resources to provide rapid deployment of merchandising resources. The Company has developed a strategy it believes will address these industry trends. The major components of PIA's strategy are as follows:

POSITION THE COMPANY AS A NATIONAL, FULL SERVICE RETAIL SOLUTIONS COMPANY

PIA's objective is to strengthen its position as a leading national

supplier of retail solutions by expanding the services it will offer including category management, data gathering, interpretation and management, to both its existing and prospective manufacturer clients and its newer and prospective retailer clients, and to offer its existing and newer services in additional retail channels.

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#### SERVE EMERGING DEMAND FOR DEDICATED SERVICES

PIA believes certain retailers and manufacturers will increasingly prefer merchandising service on a dedicated basis, and the significant size of such contracts requires substantial financial, recruitment, deployment, reporting and management capabilities. The Company believes it is positioned well to serve this emerging need for dedicated services.

#### INCREASE THE COMPANY'S UTILIZATION OF INFORMATION TECHNOLOGY

The Company has been focusing Information Technology resources on applications, which help improve productivity of field merchandisers. PIA believes a commitment to technology will provide a long term competitive advantage. The Company believes the technology it develops will present increased opportunities for PIA on project specific requests from manufacturers. PIA also expects to use technology to expand its informational services and consulting capabilities. Additionally, the Company will continue to provide its proprietary software program, Merchandisers Toolbox, to certain retailers. This program is designed to manage the deployment of manufacturer supplied labor, to measure their performance against the retailers' in-store plans and to develop databases that include a "blueprint" of a store by category. The Company also expects its key account managers will continue to use various shelf technology programs, which the Company licenses from A.C. Nielsen, IRI and Intactix.

#### DESCRIPTION OF SERVICES

The Company provides a broad array of merchandising services on a national, regional and local basis to manufacturers and retailers. PIA believes its full-line capability of developing plans at one centralized headquarters location, executing chain wide, fully integrated national solutions and implementing rapid, coordinated responses to needs on a real time basis differentiates the Company from its competitors. The Company also believes its 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 it with a competitive advantage over local, regional or retailer specific competitors.

The Company provides its merchandising and sales services primarily on behalf of consumer product manufacturers at approximately 17,000 retail grocery, 6,000 mass merchandiser and 8,800 drug stores. PIA currently provides three principal types of merchandising and sales services: shared services, dedicated services and project services.

#### SHARED SERVICES

Shared services consist of regularly scheduled, routed merchandising services provided at the store level for manufacturers. PIA's shared services are performed for multiple manufacturers including, in some cases, manufacturers whose products are in the same product category. Shared services may include activities such as:

- Ensuring that client's products authorized for distribution are in stock and on the shelf
- Adding in new products that are approved for distribution but not present 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 clients' products and

- Selling new product and promotional items.

The Company's shared services are performed principally by full-time retail sales merchandisers, retail sales specialists and key account managers, along with district and division manager supervision.

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#### RETAIL SALES MERCHANDISERS

PIA's retail sales merchandisers ("RSM") perform shared service coverage at the store level. These services include a review of the retailer's shelves and the appropriate store (or chain) prepared shelf schematic to ensure all clients' approved products are available for sale in the store, that such products have the approved shelf placement and number of facings (the horizontal and vertical space occupied by a package front) on the shelf, and the approved shelf tag is in position. If a product is not in distribution, the RSM adds the product to the shelf if it is available in the store's product storage area. If a product is unavailable, the RSM prepares a place on the shelf for this product and a shelf tag. The presence of a shelf tag is critical to a store's ability to reorder an individual stock-keeping unit ("SKU") from the distribution center. The RSM checks for the presence of and replaces, if necessary, the shelf tags for all client SKUs. The RSM also reviews all SKUs for product freshness, if appropriate, and for general salability.

#### KEY ACCOUNT MANAGERS

On behalf of its manufacturer clients, PIA selectively deploys key account managers ("KAMs") inside of the major retail chains. These KAMs, assigned exclusively to a single retailer, work with that retailer's headquarters staff in the execution of category management initiatives and in the development and implementation of shelf schematics. The KAMs provide both the manufacturer and PIA with a headquarters' perspective of the retailer and its primary objectives at the store level. The KAMs work with manufacturer clients to develop and achieve their merchandising goals, including those related to product distribution, shelf placement, the number of facings for particular products, and product adjacencies. The KAMs also work with manufacturer clients to gain retailer authorization for new products and approval of new category schematics that are compatible with the retailer's own category management strategies. PIA generally attempts to position its KAMs within the retailer's organization in a leadership capacity, both in category management and vendor deployment activities. The KAMs typically are placed within the retailer's shelf technology department and are equipped with the specific shelf technology software utilized by the retailer. The KAMs work with the retailer in the development of new shelf schematics, category layouts and, in some cases, total store space plans. The Company is also training its KAMs in category management in order to provide further value to both the Companies' manufacturer clients and to the retailer.

#### DEDICATED SERVICES

Dedicated services consist of merchandising services, generally as described above, that 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 provided are primarily based on agreed hourly rates and fixed management fees under multi-year contracts.

The Company believes it pioneered the concept of dedicated service in 1994 with a program designed for Thrifty-PayLess Drug Stores. The program covered 995 stores, and PIA was responsible for implementing product selection changes and resetting all categories to meet Thrifty-PayLess' category management plans. In implementing the program, PIA was able to ensure placement of new products on the shelf within five days of availability and completed section changes within ten days. In 1996, Rite Aid acquired Thrifty-PayLess and the contract was not renewed beyond December 1996.

In 1997, PIA started a dedicated program with CVS/Revco to convert Revco stores to the CVS format. The conversion project was a total re-merchandising of all Revco stores to the new CVS format. PIA moved gondolas, built new gondolas, and installed new fixtures and re-planogrammed all categories to the CVS conversion plan. In 1999, PIA will be responsible for new store set ups and

special projects for CVS/Revco in the state of Ohio.

The Company has not expanded the dedicated service concept during fiscal year 1998. Net revenues have decreased from 34.6% in 1997 to 31.9% in 1998, primarily due to project completions of the CVS/Revco conversions.

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#### PROJECT SERVICES

Project services consist primarily of specific in-store services initiated by retailers and manufacturers, such as new product launches, special seasonal or promotional merchandising, focused product support and product recalls. These services are used typically for large-scale implementations over 30 days. The Company also performs other project services, such as new store sets and existing store resets, re-merchandising, remodels and category implementations, under shared service contracts or stand-alone project contracts.

#### RELATED SERVICES

##### INFORMATION TECHNOLOGY SERVICES

PIA has been focusing information systems resources on applications, which help improve productivity of field merchandisers. The Labor Tracking System ("LTS") was introduced to PIA's 12 service centers in 1998. This proprietary application records actual time spent on each work initiative. The benefits of the system include real-time reporting, improved client billing, and more efficient management of the field labor.

In August 1998, the Work Generator System was implemented. This system schedules shared services and project work from a central system. It reduces the travel time by coordinating shared service work with project work. The system provides associates with a daily schedule of work assignments and expected completion times.

In September 1998, the Company began using Symbol scanners to capture inventory and returned inventory data for Buena Vista Home Entertainment ("BVHE"). BVHE retrieves the scanner information daily via the Internet from PIA's server. This information is used for daily updates to BVHE's vendor managed inventory system.

PIA also expanded the use of its Interactive Voice Response ("IVR") system. Hourly status updates can now be provided to clients on critical new item launches, such as BVHE's video releases. The IVR system can process 2,500 calls per day. This gives the Company the ability to give clients up-to-the-minute status on any work that uses the IVR system.

##### TELEMARKETING SERVICES

PIA owns 20% of Ameritel, Inc., a company that performs inbound and outbound telemarketing services, including those on behalf of certain of PIA's manufacturer clients. Ameritel provides telemarketing sales services for manufacturers that sell directly into smaller, independent retail stores. The Company believes that its affiliation with Ameritel provides an additional merchandising solution for some packaged product manufacturers and retailer clients.

The Company, in conjunction with Ameritel, developed an automated interface between the Ameritel Vantive system and the LTS. PIA associates now telephone work assignment completion information to Ameritel. PIA associates are able to report hours, mileage, and other completion information for each work assignment on a daily basis. The information is used to update the LTS the next day. This provides the 12 service centers with daily, detailed tracking of work completion.

##### RETAIL AND SECONDARY HEADQUARTERS SELLING SERVICES

The Company deploys retail sales specialists ("RSS") to provide product selling support for certain manufacturers at the retail store and secondary retailer's headquarters buying offices. These services are performed principally for manufacturers that choose to outsource their sales function for calls on



wholesaler-supplied individual stores or small chains. Sales services performed by the RSS's include product sales, selling point of sale promotions, discount and allowance programs and shelf merchandising plans.

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#### SALES AND MARKETING

The Company's sales efforts are structured to develop new business in national and local markets. At the national level, PIA's corporate business development team directs its efforts toward the senior management of prospective clients. At the regional level, sales efforts are principally guided through PIA's 12 service center offices located nationwide.

The Company's corporate account executives play an important role in PIA's new business development efforts within its existing manufacturer client base. The corporate account executives are generally located in the clients' corporate headquarters. The corporate account executives plan merchandising and product introductions with the manufacturer so that PIA can achieve the objectives of such clients' major new product and promotional initiatives. In addition, the corporate account executives present PIA's services to the sales and marketing executives of these clients, and utilize marketing data provided by IRI, A.C. Nielsen and others in an effort to ascertain additional market opportunities for such clients at the local level. Client service managers are part of the Company's geographic division teams and work with the local management of the Company's clients. The client service manager's primary responsibility is to work with the client to establish specific, measurable objectives for PIA, and to market additional services. As part of this process, the division account executive is responsible for developing retail merchandising solutions for such objectives.

As part of 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. PIA has also responded to this emerging trend by establishing client service offices that are fully staffed to provide the PIA client and the retailer with access to all of PIA's services. PIA currently has retailer teams in place at three discount and drug stores.

The Company's business development process encompasses a due diligence period to determine the objectives of the prospective client, the work to be performed to satisfy those objectives and the market value of the work to be performed. PIA 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 quotation approval form that is presented to the Company's proposal committee for approval. The pricing must meet PIA's objectives for profitability, which are established as part of the business planning process. After approval of this quotation by the proposal committee, a detailed proposal is presented to the prospective client. Following agreement regarding the elements of service and corresponding rates, a contract is prepared and executed. See "--Customers."

#### CUSTOMERS

PIA currently represents approximately 805 manufacturer clients, including approximately 648 branded product manufacturers and approximately 157 private label manufacturers. Before 1993, the Company represented its manufacturer clients primarily in the retail grocery industry. Beginning in 1993, the Company found that additional opportunities to provide its services existed throughout the much broader marketplace. This marketplace included mass merchandiser, chain drug and deep discount drug stores, as well as in other retail trade groups such as home improvement centers, computer/electronic stores, toy stores, convenience stores and office supply stores. As a result, the Company has contracted with a number of manufacturers to provide services in several additional retail markets, and has agreed to provide services to a number of retailers directly.

## COMPETITION

The third-party merchandising industry is highly competitive and is comprised of an increasing number of merchandising companies with either specific retailer, retail channel or geographic coverage, as well as food brokers. Based on information posted on the website of the National Association for Retail Merchandising Services, PIA believes there are over 150 competitors in the field of merchandising services. These companies tend to compete with the Company primarily in the retail grocery channel, and some of them may have a greater presence in certain of the retailers in whose stores the Company performs its services. The Company also competes with several companies that are national in scope, such as Powerforce, Alpha One, Pimms, and SPAR Marketing Force. These companies compete with PIA principally in the mass merchandiser, chain drug and deep discount drug retail channels. PIA believes the principal competitive factors within its industry include development of technology breadth and quality of client services, cost, and the ability to execute specific client priorities rapidly and consistently over a wide geographic area.

PIA entered into an agreement with SPAR Marketing Force and certain of its affiliates ("SPAR Group") in February 1999 which was amended in May 1999, in which PIA will essentially be acquired by SPAR Group in a merger in which all the outstanding Common Stock of SPAR will be exchanged for approximately 12.8 million shares of PIA Common Stock. See "--Recent Transaction." After the merger, the SPAR Group shareholders will own approximately 70% of PIA Common Stock.

## TRADEMARKS

PIA(R) is a registered trademark of the Company. In addition, the Company has recently commenced the process of registering the service mark for the term Precision Merchandising. Although the Company believes its trademarks may have value, the Company believes its services are sold primarily based on breadth and quality of service, cost, and the ability to execute specific client priorities rapidly and consistently over a wide geographic area. See "--Industry Overview" and "--Competition."

## EMPLOYEES

As of January 1, 1999, the Company employed approximately 1,109 full-time employees, of whom approximately 83 worked in executive, administrative and clerical capacities at the Company's corporate headquarters, and 1,026 of whom worked in division offices nationwide. In addition, the Company employed 1,030 part-time employees. Approximately 180 of the Company's employees are covered by contracts with labor unions. The Company considers its relations with its employees and its employees' unions to be good. The Company also uses the services of up to 3,000 flextime personnel whose payroll is generated through a company not affiliated with PIA.

## RECENT TRANSACTION

On February 28, 1999, PIA entered into an agreement as amended on May 14, 1999, with SPAR Group, a privately held affiliated group of companies to merge in a stock transaction. Under the agreement, PIA will issue approximately 12.8 million shares of PIA Common Stock to the stockholders of SPAR Group. SPAR Group is a privately owned provider of retail marketing and sales services offering merchandising support, incentive and motivation marketing programs, information management, marketing research, data base marketing and promotional analysis and forecasting. The transaction will be accounted for as a reverse acquisition in which SPAR Group is deemed to be the accounting acquirer. SPAR Group has annual revenues of approximately \$75 million. After the merger, SPAR Group stockholders will own approximately 70% of PIA Common Stock. The transaction requires regulatory and stockholder approval and is currently expected to close in the second quarter of 1999.

## RISK FACTORS

The following risk factors should be carefully reviewed in addition to the other information contained in this annual report on Form 10-K/A.

## PIA HAS A HISTORY OF LOSSES AND MAY BE UNPROFITABLE IN THE FUTURE

During the years ended December 31, 1997 and January 1, 1999, the Company incurred significant losses and experienced substantial negative cash flow. PIA had net losses of \$15.1 million for the fiscal year ended 1997, \$4.3 million for fiscal year 1998. The Company expects to have further losses for the first quarter of fiscal 1999. As noted, the Company has entered into a merger agreement with SPAR Group. If the merger is not completed, the Company will be required to significantly reduce its operating costs to minimize the effects of further reductions in revenues and operating losses. PIA cannot guarantee that it will not sustain further losses or that it will operate profitably in the future. Losses in 1997 were primarily caused by margin reductions from the loss of shared service clients, inefficiencies in field labor execution, poor pricing decisions for some client contracts and higher business unit overhead costs. The recognition of \$5.4 million in restructuring and other charges was also responsible for the losses. Losses in 1998 primarily were caused by margin reductions and from a decline in revenues due to loss of shared service clients and completion of dedicated projects. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

## PIA MAY HAVE DIFFICULTY MEETING ITS FUTURE CASH NEEDS

For the year ended January 1, 1999, PIA experienced a decrease in cash and cash equivalents of \$1.9 million. PIA expects to have further decreases in cash in 1999. There can be no assurance that PIA will be able to generate sufficient cash or increase its credit line in order to operate its business following this 12 month period. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources."

## THE CONTINUED LOSS OR REDUCTION OF BUSINESS WILL HURT PIA'S FINANCIAL PERFORMANCE

PIA's business mix has changed significantly over the last year, and is expected to continue to change during 1999, in response to client needs, and the evolving third party merchandising industry. Due in part to the completion of a major dedicated client program, and the loss of several shared service clients, sales have declined over the last 18 months, and no sizable new dedicated business has been sold to compensate for these losses. The Company has reduced its dedicated management and personnel infrastructure accordingly.

## INDUSTRY CONSOLIDATION HAS ADVERSELY AFFECTED PIA'S BUSINESS

Because of industry consolidation, PIA has lost certain clients, and this trend could continue to have a negative effect on PIA's client base and results of operations. The retail and manufacturing industries are undergoing consolidation processes that result in larger but fewer retailers and suppliers. PIA's success depends in part upon its ability to maintain its existing clients and to obtain new clients.

## PIA'S REVENUES DEPEND LARGELY ON A FEW CLIENTS

PIA's ten largest clients generated approximately 75% of PIA's net revenues for the year ended January 1, 1999, and approximately 69% for the year ended December 31, 1997. During the year ended January 1, 1999 none of PIA's manufacturer or retailer clients accounted for greater than 10% of net revenues other than Eckerd Drug Stores, CVS Pharmacy Incorporated and Buena Vista Home Entertainment, which accounted for 15.6%, 12.6% and 10.6%, respectively. During the year ended December 31, 1997, none of PIA's manufacturer or retailer clients accounted for greater than 10% of net revenues other than Buena Vista Home Entertainment and Eckerd Drug Stores which accounted for 16.0% and 13.6% of net revenues, respectively. The majority of the Company's contracts with its clients

for shared services have multi-year terms. PIA believes the uncollectibility of amounts due from any of its large clients, a significant reduction in business from such clients, or the inability to attract new clients, could have a material adverse effect on the Company's results of operations.

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#### PIA'S OPERATING RESULTS MAY FLUCTUATE BECAUSE ITS COMMISSION INCOME IS UNCERTAIN

Approximately 15% of the Company's net revenues for the year ended January 1, 1999 were earned under commission-based contracts. These contracts provide for commissions based on a percentage of the client's net sales of certain of its products to designated retailers. Under certain of these contracts, the Company generally receives a draw on a monthly or quarterly basis, which is then applied against commissions earned. Adjustments are made on a monthly or quarterly basis upon receipt of reconciliations between commissions earned from the client and the draws previously received. The reconciliations typically result in commissions owed to the Company in excess of previous draws; however, the Company cannot predict with accuracy the level of its clients' commission-based sales. Accordingly, the amount of commissions in excess of or less than the draws previously received will fluctuate and can significantly affect the Company's operating results in any quarter.

#### PIA IS CONTROLLED BY A FEW STOCKHOLDERS

Riordan, Lewis & Haden ("RLH"), a private investment firm, beneficially owns approximately 29.7% of PIA's outstanding Common Stock. PIA's directors and officers, in the aggregate, beneficially own approximately 16.2% of PIA's outstanding Common Stock (excluding the shares owned by Riordan, Lewis & Haden which are deemed to be beneficially owned by Mr. Haden and Mr. Lewis). While not controlling a majority of the outstanding shares, RLH, and the directors and officers acting together generally will have significant influence with respect to the election of directors and other matters submitted to the PIA stockholders, including amendments to PIA's charter and Bylaws and approval of certain mergers or similar transactions and sales of all or substantially all of PIA's assets. If the merger with the SPAR Group is consummated, the current stockholders of SPAR Group will beneficially own approximately 70% of PIA's outstanding Common Stock. Accordingly, if they act as a group they will generally be able to elect all directors and they will have the power to prevent or cause a change in control of PIA. Such concentration of ownership could have the effect of making it more difficult for a third party to acquire control of PIA in the future, and may discourage third parties from attempting to do so.

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#### GLOSSARY

The following glossary includes definitions of certain general industry terms as well as terms relating specifically to the company.

**CATEGORY** - A segment or sub-segment of a department within a retail outlet. For example, the health and beauty care department consists of several categories such as oral care and shampoo; and the shampoo section is divided into sub-categories such as salon formulas and dandruff control.

**CATEGORY MANAGEMENT** - A process for managing a retailer's or a manufacturer's business that recognizes categories as strategic business units for the purpose of planning sales and profit objectives.

**CAUSAL DATA** - Data that defines the factors within a retail outlet that impact sales. These factors usually include display, pricing and product adjacency information.

EFFICIENT CONSUMER RESPONSE (ECR) - A grocery industry strategy in which retailers and manufacturers incorporate the principles of efficient replenishment with effective assortment and promotion of products.

FACING - The horizontal and vertical space occupied by a package front when displayed on a store shelf.

KEY ACCOUNT MANAGER (KAM) - A KAM is assigned exclusively to a single retailer and works with that retailer's corporate headquarters staff in the execution of category management initiatives and in the development and implementation of shelf schematics.

MASS MERCHANDISER - The segment of retailers that offers multi-departments in a single location, each of which is typically quite large (at least 75,000 square feet). Examples include Kmart and Wal\*Mart.

NEW STORE SET - The initial merchandising of a new retail outlet that was either built or acquired.

OUT-OF-STOCK - A situation that exists when a product normally carried by a retailer is temporarily unavailable. This means that shelf allocation exists, but inventory has been depleted.

RE-MERCHANDISING - A retail unit that is enhanced by the relocation of sections, aisles and/or departments, and usually involves the total store.

REMODEL - A retail unit that is enhanced by enlargement and/or redesign. Structural changes most often result in departments and/or services being added or deleted, which requires the relocation of most products and sections within the store.

RESET - Relocation of products within a given category or section of a retail store. A reset typically involves removal of all products from the retailer's shelves, restocking of products and reallocation of space.

RETAIL AND SECONDARY HEADQUARTERS SELLING - Refers to the selling of products and/or taking of orders in chains which do not operate their own warehouses and in stores having the authority to purchase and/or approve orders.

RETAIL SALES MERCHANDISERS (RSM) - An RSM is a full-time associate who performs shared service coverage at the store level.

RETAIL SALES SPECIALIST (RSS) - A retail sales specialist provides product selling support for certain manufacturers at the retail store and secondary retailers headquarters buying offices.

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RETAILER - An operator of retail stores or groups of retail stores that are also referred to as chains.

SCHEMATIC - A diagram that lists the specific location and shelf space to be allocated for all items within a section. The schematic also contains data relating to merchandising such as width, depth of shelving, shelf elevations and height of gondola.

SHARED SERVICES - A group of associates who perform specific functions for multiple clients on each store visit.

STOCK KEEPING UNIT (SKU) - A unit of product having its own unique size/weight and product description.

VOID - A situation that exists when a retailer does not carry a product and there is no allocated space or reorder tag present.

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ITEM 2. PROPERTIES.

The Company maintains its corporate headquarters in approximately 20,000 square feet of leased office space located in Irvine, California, under a lease with a term expiring in February 2000.

The Company leases certain office and storage facilities for its divisions and subsidiaries under operating leases, which expire at various dates during the next five years. Most of these leases require the Company to pay minimum rents, subject to periodic adjustments, plus other charges including utilities, real estate taxes and common area maintenance.

The following is a list of the locations where the Company maintains leased facilities for its division offices and subsidiaries:

|                           |                                  |
|---------------------------|----------------------------------|
| Scottsdale, Arizona       | Southfield, Michigan             |
| Rogers, Arkansas          | Chesterfield Missouri            |
| Irvine, California        | Edison, New Jersey               |
| Pleasanton, California    | Albuquerque, New Mexico          |
| Englewood, Colorado       | Blue Ash, Ohio                   |
| Tampa, Florida            | Cranberry Township, Pennsylvania |
| Norcross, Georgia         | Carrollton, Texas                |
| Oakwood Terrace, Illinois | Houston, Texas                   |
| Overland Park, Kansas     | Bellevue, Washington             |
| Woburn, Massachusetts     |                                  |

Although the Company believes that its existing facilities are adequate for its current business, new facilities may be added should the need arise in the future. Certain of the above facilities may be closed or subleased as the Company streamlines its operations.

ITEM 3. LEGAL AND ADMINISTRATIVE PROCEEDINGS.

On February 25, 1998, the Company and its Canadian subsidiary were served with two Statements of Claim in the Ontario court (General Division) of the Province of Ontario, Canada, filed by Merchandising Consultants Associates ("MCA") asserting claims for alleged breach of Confidentiality Agreements dated October 19, 1996 and July 17, 1997. Both of these lawsuits assert that the Company and its subsidiary improperly used confidential information provided by MCA as part of the Company's due diligence concerning its proposed acquisition of MCA, including alleged clientele, contracts, financial statements and business opportunities of MCA. In addition, MCA contends that the Company breached and allegedly reneged upon the terms for acquisition of MCA contained in a Letter of Intent between the parties dated July 17, 1997, which by its express terms was non-binding. The Statements of Claim sought damages totaling \$10.2 million.

The Company has agreed to settle the MCA lawsuit. Both parties have agreed to drop the lawsuit for no compensation and to execute a Full and Final Release, releasing each other from all claims.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS.

PRICE RANGE OF COMMON STOCK

The following table sets forth the reported high and low sales prices of the Common Stock for the quarters indicated as reported on the Nasdaq National Market. The Common Stock is traded on the Nasdaq National Market under the symbol "PIAM".

|                | 1997     |         | 1998    |         |
|----------------|----------|---------|---------|---------|
|                | High     | Low     | High    | Low     |
| First Quarter  | \$11.000 | \$5.125 | \$6.500 | \$5.000 |
| Second Quarter | 7.125    | 5.375   | 8.156   | 3.688   |
| Third Quarter  | 8.250    | 5.125   | 6.844   | 4.125   |
| Fourth Quarter | 9.000    | 4.875   | 4.875   | 2.000   |

As of May 1, 1999, there were approximately 801 holders of record of the Company's Common Stock.

The Company has never declared or paid any cash dividends on its capital stock and does not anticipate paying cash dividends on its Common Stock in the foreseeable future. The Company currently intends to retain future earnings to finance its operations and fund the growth of its business. Any payment of future dividends will be at the discretion of the Board of Directors of the Company and will depend upon, among other things, the Company's earnings, financial condition, capital requirements, level of indebtedness, contractual restrictions in respect to the payment of dividends and other factors that the Company's Board of Directors deems relevant.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA.

The following selected consolidated financial data sets forth, for the periods and the dates indicated, summary consolidated financial data of the Company and its subsidiaries. Below, with respect to the three years ending December 31, 1996, December 31, 1997 and January 1, 1999 is the consolidated statement of operations and the consolidated balance sheet data as of December 31, 1997 and January 1, 1999 have derived from, and are qualified by reference to the audited consolidated financial statements included elsewhere in this Form 10-K. These statements should be read in conjunction with such financial statements and related notes thereto in "Management's Discussion and Analysis of Financial Condition and Results of Operations."

|                                     | YEARS ENDED                           |                 |                 |                 |                |
|-------------------------------------|---------------------------------------|-----------------|-----------------|-----------------|----------------|
|                                     | DEC 31,<br>1994                       | DEC 31,<br>1995 | DEC 31,<br>1996 | DEC 31,<br>1997 | JAN 1,<br>1999 |
|                                     | (in thousands, except per share data) |                 |                 |                 |                |
| STATEMENT OF OPERATIONS DATA:       |                                       |                 |                 |                 |                |
| Net revenues                        | \$ 80,449                             | \$ 104,791      | \$ 119,940      | \$ 128,208      | \$ 121,788     |
| Operating expenses:                 |                                       |                 |                 |                 |                |
| Field services costs                | 61,876                                | 81,320          | 94,841          | 119,830         | 105,448        |
| Selling expenses                    | 9,028                                 | 10,339          | 11,133          | 10,482          | 8,245          |
| General and administrative expenses | 5,800                                 | 6,810           | 8,081           | 10,234          | 11,788         |
| Restructure and other charges       | --                                    | --              | --              | 5,420           | --             |
| Depreciation and amortization       | 339                                   | 497             | 595             | 997             | 1,129          |
| Total operating expenses            | 77,043                                | 98,966          | 114,650         | 146,963         | 126,610        |
| Operating income (loss)             | 3,406                                 | 5,825           | 5,290           | (18,755)        | (4,822)        |
| Other income                        | (725)                                 | (465)           | 895             | 895             | 611            |

|   |          |          |          |             |            |
|---|----------|----------|----------|-------------|------------|
| Income (loss) before provision (benefit) for income taxes | 2,681    | 5,360    | 6,185    | (17,860)    | (4,211)    |
| Income tax provision (benefit)                            | 101      | 1,829    | 2,426    | (2,761)     | 55         |
| Net income (loss)   | \$ 2,580 | \$ 3,531 | \$ 3,759 | \$ (15,099) | \$ (4,266) |
| Net income (loss) per share - basic(1)                    | \$ 0.88  | \$ 1.13  | \$ 0.70  | \$ (2.72)   | \$ (0.78)  |
| Weighted average shares - basic(1)                        | 2,923    | 3,117    | 5,370    | 5,551       | 5,439      |
| Net income (loss) per share - diluted(1)                  | \$ 0.68  | \$ 0.89  | \$ 0.63  | \$ (2.72)   | \$ (0.78)  |
| Weighted average shares - diluted(1)                      | 3,895    | 3,981    | 5,990    | 5,551       | 5,439      |

|  | Dec 31,<br>1994 | Dec 31,<br>1995 | Dec 31,<br>1996 | Dec 31,<br>1997 | Jan 1,<br>1999 |
|--|-----------------|-----------------|-----------------|-----------------|----------------|
|  | -----           | -----           | -----           | -----           | -----          |
|  | (in thousands)  |                 |                 |                 |                |
| BALANCE SHEET DATA:                    |                 |                 |                 |                 |                |
| Working capital                        | \$ 3,642        | \$ 7,131        | \$32,737        | \$15,938        | \$13,844       |
| Total assets                           | 10,224          | 16,086          | 47,672          | 36,467          | 26,054         |
| Current portion of long-term debt      | 277             | --              | --              | --              | --             |
| Long-term debt, net of current portion | 3,274           | 3,400           | --              | --              | 2,000          |
| Total stockholders' equity             | 2,481           | 5,988           | 36,718          | 18,67           | 14,724         |

(1) Net income (loss) per share has been restated for all applicable periods presented in accordance with the adoption of SFAS No. 128 Earnings per share.

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#### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

PIA provides merchandising services to manufacturers and retailers principally in grocery, mass merchandiser and chain and discount drug stores. For the years ended December 31, 1997, and January 1, 1999, the Company generated approximately 74% and 59% of its net revenues from manufacturer clients and 26% and 41% from retailer clients, respectively.

During the five years that ended January 1, 1999, none of the Company's manufacturer or retailer clients accounted for greater than 10% of the Company's net revenues, other than Thrifty-Payless, which accounted for approximately 13% of net revenues for the year ended December 31, 1995, and BVHE and S.C. Johnson which accounted for 11.7% and 10.3% of net revenues, respectively, for the year ended December 31, 1996, and BVHE and Eckerd Drug Stores which accounted for approximately 16.0% and 13.6% respectively, of net revenues for the year ended December 31, 1997, and Eckerd Drug Store, CVS Pharmacy, and BVHE which accounted for approximately 15.6%, 12.6% , and 10.6% respectively, of net revenues for the year ended January 1, 1999.

During the fiscal year 1998, the Company continued to experience a decline in its shared service business. Shared services consist of regularly scheduled, routed merchandising services provided at the store level for manufacturers, primarily under multi-year contracts. Due in part to industry consolidation, increased competition, and performance, the Company lost a number of shared service clients in 1997 and 1998. The Company has historically required a significant fixed management and personnel infrastructure to support shared services. Accordingly, the loss of shared services business, without offsetting gains, had a material adverse effect on the Company's results of operations in 1997 and 1998. These losses have been partially offset with additional project revenue from shared service clients. In 1997 and 1998, shared service client's accounted for \$83.8 and \$83.0 million in net revenue and dedicated clients accounted for \$44.4 and \$38.8 million in net revenue, respectively. The Company believes revenues in fiscal year 1999 from shared service clients will decline as a result of the wind-down of the lost business.

The Company's profitability has been adversely affected by the loss of its dedicated client services business in 1998. However, this decline has been offset by an increase in gross margin, both in absolute amount and as a



percentage of net revenues, as a result of the effects of improved labor productivity and service cost reduction in the field. Dedicated services consist of merchandising services that are performed for a specific retailer or manufacturer by a dedicated organization, including a management team, working exclusively for that retailer or manufacturer. The net revenues associated with dedicated clients decreased as a percentage of overall net revenues, from 34.6% in 1997 to 31.9% in 1998.

Due to the change in business mix, and resulting negative impact on margins, the Company realigned its cost structure, and, in the third quarter of 1997, recorded a charge of \$5.4 million for restructuring and other costs associated with the realignment of management structure and the organization. The Company continues to review its organizational structure and the fixed and variable costs associated with delivery of its services. It is anticipated that further organizational changes will take place in the fiscal year 1999, as the Company puts structure, programs and processes in place to reduce its fixed overhead in line with lower revenue levels.

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The following table sets forth certain financial data as a percentage of net revenues for the periods indicated:

|   | YEARS ENDED          |                      |                    |
|---|----------------------|----------------------|--------------------|
|   | DECEMBER 31,<br>1996 | DECEMBER 31,<br>1997 | JANUARY 1,<br>1999 |
| Net revenues  | 100.0%               | 100.0%               | 100.0%             |
| Operating expenses:                                       |                      |                      |                    |
| Field services costs                                      | 79.1                 | 93.5                 | 86.6               |
| Selling expenses  | 9.3                  | 8.2                  | 6.8                |
| General and administrative expenses                       | 6.7                  | 8.0                  | 9.7                |
| Restructure and other charges                             | 0.0                  | 4.2                  | 0.0                |
| Depreciation and amortization                             | 0.5                  | 0.8                  | 0.9                |
| Total operating expenses                                  | 95.6                 | 114.7                | 104.0              |
| Operating income (loss)                                   | 4.4                  | (14.7)               | (4.0)              |
| Other income  | 0.8                  | 0.7                  | 0.5                |
| Income (loss) before provision (benefit) for income taxes | 5.2                  | (14.0)               | (3.5)              |
| Provision (benefit) for income taxes                      | 2.0                  | (2.2)                | --                 |
| Net income (loss)   | 3.2%                 | (11.8)%              | (3.5)%             |

YEAR ENDED JANUARY 1, 1999 COMPARED TO YEAR ENDED DECEMBER 31, 1997

#### NET REVENUES

For fiscal year 1998, net revenues were \$121.8 million, compared to \$128.2 million in 1997, a 5.0% decrease. Shared service and project client net revenues decreased from \$83.8 million in 1997 to \$83.0 million in 1998, a decrease of \$0.8 million or 1.0%. In 1998, the traditional shared services, consisting of regularly scheduled routed merchandising service, decreased from \$44.9 million in 1997 to \$40.1 million. This decrease of \$4.8 million or 10.7% was due in part to industry consolidation, increased competition and client reorganization of marketing strategy. During the same period project revenues for shared service clients increased by \$4.0 million or 10.3% primarily due to a major client switching from a dedicated program to a shared service program. The Company's dedicated client net revenues declined from \$44.4 million in 1997 to \$38.8 million in 1998, representing a 12.6% decrease. This decrease in dedicated client net revenues resulted primarily from the completion of a major drug chain dedicated program. Management expects that net revenues from dedicated clients will decrease in 1999 due to the completion of a \$15.0 million project in the last quarter of 1998.

The following table sets forth net revenues by client type as a percentage of net revenues for the periods indicated:

|  | YEARS ENDED          |        |                       |        |          |        |
|--|----------------------|--------|-----------------------|--------|----------|--------|
|  | DECEMBER 31,<br>1997 |        | JANUARY 1,<br>1999    |        | CHANGE   |        |
|  | AMOUNT               | %      | (dollars in millions) |        | AMOUNT   | %      |
|  | -----                | -----  | AMOUNT                | %      | -----    | -----  |
| Shared service and project client net revenues | \$ 83.8              | 65.4%  | \$ 83.0               | 68.1%  | \$ (0.8) | (1.0)% |
| Dedicated client net revenues                  | 44.4                 | 34.6   | 38.8                  | 31.9   | (5.6)    | (12.6) |
| Net revenues                                   | \$ 128.2             | 100.0% | \$ 121.8              | 100.0% | \$ (6.4) | (5.0)% |

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#### OPERATING EXPENSES

Field service costs were \$105.4 million in the fiscal year 1998 compared to \$119.8 million in 1997, representing a decrease of \$14.4 million, or 12.0%. As a percentage of net revenues, field service costs were 93.5% of net revenues in 1997 versus 86.6% of net revenues in 1998. Field service costs are comprised principally of field labor and related costs and overhead expenses required to provide services to both dedicated and shared service clients. The decrease in field service costs is primarily due to significant labor efficiency savings from new labor deployment systems and controls and a decline in services due to the completion of a dedicated project in the third quarter 1998.

Selling expenses were \$8.2 million in 1998, compared to \$10.5 million in the prior year. As a percentage of net revenues, selling expenses were 6.8% in 1998, compared to 8.2% in 1997. This decrease in costs, both in absolute amount and as a percentage of net revenues, is a result of lower staffing and travel expenses.

General and administrative expenses increased 15.2% in 1998 to \$11.8 million, compared to \$10.2 million in 1997. This increase was due primarily to consulting and promotional expenses of \$1.0 million, salary and salary related expenses of \$0.5 million to support technology advancements, office equipment and leases of \$0.7 million, offset by a reduction in bad debt provision of \$0.8 million due to improved collection of outstanding accounts.

Restructuring and other charge payments of \$5.0 million did not significantly differ from the initial restructuring and other charges expense. In addition, accrued liabilities for restructuring at January 1, 1999 of \$0.4 million will be sufficient to pay remaining employee separation costs and special computer equipment under long-term operating leases no longer in use. (See Note F-12).

Depreciation and amortization expenses were \$1.1 million in 1998 compared to \$1.0 million in 1997, an increase of \$0.1 million as a result of depreciation, amortization on computer hardware, software development costs for shelf technology and for general business purposes.

#### OTHER INCOME

Interest income decreased 42.2% or \$0.3 million in 1998 compared to 1997, due to lower cash balances available for investment in 1998.

Equity in earnings of affiliate represents the Company's share of the earnings of Ameritel, Inc., a full service telemarketing company. Equity of earnings of affiliate increased 55.2% or 0.1 million in 1998 compared to 1997. During 1996, the Company exercised its option to increase its ownership of Ameritel to 20% and is now required for financial reporting purposes to recognize its equity interest in Ameritel's earnings.

#### INCOME TAXES

Income tax expense was approximately \$0.1 million in 1998, compared to an income tax benefit of \$2.8 million in 1997, representing an effective rate of 1.3% and (15.5)%, respectively. The 1998 tax rate differed from the expected

federal tax rate of 35% due to a valuation allowance of \$1.6 million on the Company's deferred tax asset, caused by a net operating loss carryforward created in 1998 and the uncertainty over the future utilization of such carryforwards. An income tax benefit in 1997 was derived from carrying back net operating losses to previous years and obtaining an income tax refund of \$2.9 million.

#### NET LOSS

The Company incurred a net loss of approximately \$4.3 million in 1998, \$0.78 per diluted share, compared to a net loss of approximately \$15.1 million, or \$2.72 per diluted share, in 1997. The improved performance during 1998 was primarily due to labor efficiency savings from utilizing new labor systems and controls, reduction in field service costs from the implementation of the 1997 restructure programs. The loss incurred in 1998 is primarily a result of margin reductions because of reductions in dedicated clients and higher business unit overhead rates.

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#### NEW FINANCIAL MODEL

The Company has developed a new financial model with which its business can be analyzed to assist in the understanding of the operating results and impact of various cost functions within the organization. This model follows more standard metrics and allows the Company to analyze and manage at the business unit level. The following table illustrates this financial model for the years ended December 31, 1997 and January 1, 1999.

Management expects to continue to review the business results based on the comparable financial statement format contained in this Form 10-K until comparisons can be made using the new financial model.

|  | YEARS ENDED         |                            |                   |               |
|--|---------------------|----------------------------|-------------------|---------------|
|  | DECEMBER 31<br>1997 |                            | JANUARY 1<br>1999 |               |
|  | AMOUNT              | (dollars in millions)<br>% | AMOUNT            | %             |
| Net revenues   | \$128.2             | 100.0%                     | \$121.8           | 100.0%        |
| Direct business unit field expense   | 98.7                | 77.0                       | 88.9              | 73.0          |
| Gross margin   | 29.5                | 23.0                       | 32.9              | 27.0          |
| Overhead and allocated field expense   | 26.6                | 20.7                       | 20.8              | 17.1          |
| Business unit margin   | 2.9                 | 2.3                        | 12.1              | 9.9           |
| Selling, general and administrative expenses                                   | 15.3                | 11.9                       | 15.8              | 12.9          |
| Restructure and non-recurring charges  | 5.4                 | 4.2                        | 0.0               | 0.0           |
| Total selling, general and administrative expenses                             | 20.7                | 16.1                       | 15.8              | 12.9          |
| Earnings (loss) before interest, taxes, depreciation and amortization (EBITDA) | (17.8)              | (13.8)                     | (3.7)             | (3.0)         |
| Depreciation and amortization  | (1.0)               | (0.8)                      | (1.1)             | (0.9)         |
| Other income   | 0.9                 | 0.7                        | 0.6               | 0.5           |
| Income tax benefit (provision)   | 2.8                 | 2.1                        | (0.1)             | (0.1)         |
| Net loss   | <u>\$ (15.1)</u>    | <u>(11.8)%</u>             | <u>\$ (4.3)</u>   | <u>(3.5)%</u> |

#### YEAR ENDED DECEMBER 31, 1997 COMPARED TO YEAR ENDED DECEMBER 31, 1996

##### NET REVENUES

For 1997, net revenues were \$128.2 million, compared to \$119.9 million in 1996, a 6.9% increase. The Company's dedicated client net revenues had grown

from \$21.9 million in 1996 to \$44.4 million in 1997, a 102.7% increase. This increase in dedicated client net revenues resulted from the addition of two major new clients. Shared service and project client net revenues decreased from \$98.0 million in 1996 to \$83.8 million in 1997, a decrease of \$14.2 million or 14.5%. In 1997, the traditional shared services, consisting of regularly scheduled routed merchandising services, decreased from \$68.4 million in 1996 to \$44.9 million in 1997. Resulting in a decrease of \$23.5 million or 34.4%, while project revenues for shared clients increased to \$9.3 million or 31.4%

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The following table sets forth net revenues by client type as a percentage of net revenues for the periods indicated:

|  | YEARS ENDED          |        |                       |        |           |         |
|--|----------------------|--------|-----------------------|--------|-----------|---------|
|  | DECEMBER 31,<br>1996 |        | DECEMBER 31,<br>1997  |        | CHANGE    |         |
|  | AMOUNT               | %      | (dollars in millions) |        | AMOUNT    | %       |
| Shared service and project client net revenues | \$ 98.0              | 81.7%  | \$ 83.8               | 65.4%  | \$ (14.2) | (14.5)% |
| Dedicated client net revenues                  | 21.9                 | 18.3   | 44.4                  | 34.6   | 22.5      | 102.7   |
| Net revenues                                   | \$119.9              | 100.0% | \$128.2               | 100.0% | \$ 8.3    | 6.9 %   |

#### OPERATING EXPENSES

In 1997, field service costs increased \$25.0 million, or 26.3%, to \$119.8 million, as compared to \$94.8 million in 1996. As a percentage of net revenues, field service costs were 79.1% of net revenues in 1996 versus 93.5% of net revenues in 1997. Field service costs are comprised principally of field labor and their related costs, and overhead expenses required to provide services to both dedicated and shared service clients. The increase in field service costs is due primarily to labor costs required to provide the necessary level of business support for dedicated clients. In addition, the Company did not adequately decrease shared client service labor and overhead costs as the net revenue from this client base decreased.

Selling expenses were \$10.5 million in 1997, compared to \$11.1 million in 1996. As a percentage of net revenues, selling expenses were 8.2% in 1997, compared to 9.3% in 1996. This decrease in costs, both in absolute amount and as a percentage of net revenues, is a result of lower staffing and travels.

General and administrative expenses increased 25.9% in 1997 to \$10.2 million, compared to \$8.1 million in 1996. The increase in general and administrative expenses was due to increases in expenses that were required to support overall business growth, including a larger dedicated client base. The major increases included executive salaries and salary related expenses of \$0.3 million, recruiting, employment and training of \$0.3 million, and consulting, legal and office lease expense of \$0.6 million. In addition, increased costs were experienced due to termination costs.

During 1997, the Company experienced declining gross margins, and resultant operating losses, due to service performance issues and the loss of several shared clients. This decline in margins has resulted in insufficient margin dollars to cover the overhead structure, which had developed at the field level and in the general corporate area. In the quarter ended September 30, 1997, the Company began to address these conditions by restructuring its operations. The Company redirected its focus in the quarter ended September 30, 1997, on a more disciplined and functional structure. These strategies resulted in a \$5.4 million charge for the restructuring and other additional charges. The restructure and other charges consisted of \$1.5 million of identified severance, lease costs in various management and administrative functions and \$2.1 million in write-downs and accruals associated with the redirection of the Company's technology strategies. Additional charges consist primarily of \$1.3 million of

reserves, write-offs related to unprofitable contracts and \$0.5 million of costs associated with changes in the Company's service delivery model.

Depreciation and amortization expenses were \$1.0 million in 1997 compared to \$0.6 million in 1996. The depreciation and amortization on computer hardware and the software development costs for shelf technology increased this expense \$0.4 million.

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#### OTHER INCOME

Interest income decreased slightly in 1997 compared to 1996, due to lower cash balances available for investment in 1997. Other income included interest income on the net proceeds from the Company's initial public offering, which took place in March 1996.

Equity in earnings of affiliate represents the Company's share of the earnings of Ameritel, Inc., a full service telemarketing company. Equity in earnings of affiliate increased by 33.3% in 1997 compared to 1996. During 1996, the Company exercised its option to increase its ownership of Ameritel to 20% and is now required for financial reporting purposes to recognize its equity interest in Ameritel earnings.

#### INCOME TAXES

Income tax benefit was approximately \$2.8 million in 1997, compared to income tax expense of \$2.4 million in 1996, representing an effective rate of (15.5%) and 39.2%, respectively. The 1997 tax benefit rates differed from the expected Federal and tax rate of 35% due to a valuation allowance of \$3.6 million on the Company's deferred tax asset, caused by a net operating loss carryforward created in 1997.

#### NET LOSS

The Company incurred a net loss of approximately \$15.1 million in 1997, \$2.72 per diluted share, compared to net income of approximately \$3.8 million, or \$0.63 per diluted share, in 1996. The net loss for 1997 included the net impact, after related tax benefit, of restructure and other charges of \$4.6 million, or \$0.83 per diluted share. The loss incurred in 1997 is primarily a result of margin reductions due to reductions in shared service clients and start up expenses on dedicated client services, inefficiencies in field labor execution, poor pricing decisions for some client contracts, higher business unit overhead costs and the recognition of restructure charges and other non-reoccurring charges.

#### LIQUIDITY AND CAPITAL RESOURCES

On March 1, 1996, the Company completed an initial public offering of its Common Stock, raising \$26.5 million. Prior to this offering, the Company's primary sources of financing were senior borrowings from a bank under a revolving line of credit and subordinated borrowings from two stockholders. As of January 1, 1999, the Company used the proceeds from the offering to repay bank debt of \$3.4 million, to repurchase 507,000 shares of the Company's stock for approximately \$3.0 million and to fund the Company's operating losses in 1997 and 1998. During the year ended January 1, 1999, the Company had a net decrease in cash of \$1.9 million, resulting from its operating losses and restructure charge payments and a reduction in accounts payable, that were offset partially by a reduction in accounts receivable, income tax receivable and proceeds of \$2.0 million from its line of credit.

In March 1997, the Company's Board of Directors approved a stock repurchase program under which the Company was authorized to repurchase up to 1,000,000 shares of Common Stock from time to time in the open market, depending on market conditions. This program was funded by proceeds from the initial public offering. As of July 14, 1997, the Company repurchased an aggregate of 507,000 shares of its Common Stock for an aggregate price of approximately \$3.0 million. No further repurchases are currently planned.

In December 1998, PIA Merchandising Co., Inc. ("PIA Co.") and another subsidiary of PIA entered into a loan and security agreement with Mellon Bank,

N.A. The agreement provides for a revolving line of credit that allows maximum borrowing of \$20.0 million and requires PIA Co. to borrow and maintain a minimum balance of \$2.0 million. The three-year credit facility will be used for working capital purposes and potential acquisitions.

Cash and cash equivalents totaled \$11.1 million at January 1, 1999 compared with \$13.0 million at December 31, 1997. At January 1, 1999 and December 31, 1997, the Company had working capital of \$13.8 million and \$15.9 million, respectively, and current ratios of 2.50 and 1.95, respectively.

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Net cash used in operating activities in 1998 was \$3.4 million, compared with \$2.8 million in 1997. This use of cash for operating activities in 1998 resulted primarily from net operating losses of \$4.3 million and a reduction in accrued liabilities primarily attributed to the Company's 1997 restructuring and other charges and a reduction in accounts payable of \$2.2 million related to a reduction in third party payroll liability. These uses were offset by an income tax refund of \$2.9 million outstanding in 1997 and a decrease in account receivable of \$5.1 million from improved collection of outstanding accounts. Net cash used in investing activities for 1998 was \$0.7 million compared to \$0.8 million in 1997 from additions to property and equipment and internally developed software. Net cash provided by financing activities for 1998 was \$2.1 million, compared to net cash used in financing activities of \$2.9 million in 1997. In 1998 the Company received net proceeds from the issuance of common stock of \$0.1 million and increased the line of credit by \$2.0 million.

The above activity resulted in a decrease in cash and cash equivalents of \$1.9 million for the year ended January 1, 1999.

Cash and cash equivalents and the timely collection of its receivables provide the Company's current liquidity. However, the potential uncollectibility of receivables due from any of PIA's major clients, or a significant reduction in business from such clients, or the inability to acquire new clients would have an adverse material effect on the Company's cash resources and its ongoing ability to fund operations.

The Company had a 4.3 million loss and experienced a decrease in cash and cash equivalents of \$1.9 million for the year ended January 1, 1999. However, with the addition of the revolving line of credit, timely collection of receivables, and the Company's positive working capital position, management believes the funding of operations over the next twelve months will be sufficient.

PIA may incur additional indebtedness in 1999 in connection with the merger. SPAR Group acquired the assets of an incentive marketing company in January 1999. A portion of the purchase price was paid through the issuance of a promissory note in the principal amount of \$12,422,189 (plus an earn out, if any), which matures on September 15, 1999. As of March 31, 1999, the amount owed under the note was estimated to be \$10.8 million, excluding the earn out payment, if any. In addition, the principal stockholders of SPAR Group loaned SPAR Group \$2,958,000 to facilitate the acquisition. If this indebtedness is not repaid before the transaction with PIA is consummated, the combined company will assume these obligations along with other liabilities of SPAR Group. PIA will also be obligated, under certain circumstances, to pay severance compensation to its employees in connection with the merger. Further, PIA will incur substantial costs in connection with the transaction, including legal, accounting and investment banking fees and severance payments of an aggregate of approximately \$00.0 million. PIA is currently negotiating with major banks for a \$50 million revolving line of credit to meet cash needs in connection with the merger and future potential acquisitions in 1999. PIA cannot provide any assurance that it will be able to secure a \$50 million revolving line of credit.

#### YEAR 2000 SOFTWARE COSTS

Many currently installed computer systems and software products are coded to accept only two digit entries in the date code field. As a result, many date-sensitive computer applications will fail beginning January 1, 2000 because

they are unable to process dates properly beyond December 31, 1999. PIA has reviewed its computer systems to identify areas that could be affected by Year 2000 issues and has implemented a plan to resolve these issues.

PIA has substantially completed the evaluation of its information technology infrastructure, software, hardware and communications systems. PIA believes that its critical hardware and software applications are currently Year 2000 compliant. Completion of PIA's plan to upgrade all hardware and software applications to be Year 2000 compliant is expected by the third quarter of 1999. Third party vendors are also being reviewed for Year 2000 compliance and PIA expects this risk assessment to be complete by the second quarter of 1999. PIA's assessment and evaluation efforts include testing systems, inquiries of third parties and other research. By implementing significant systems upgrades, PIA believes that it has substantially reduced its potential internal exposure to Year 2000 problems.

The most reasonably likely worst case scenario involves Year 2000 problems experienced by PIA's staffing suppliers. In such a scenario PIA's ability to efficiently deploy the necessary staff to service its clients' needs could be negatively affected. PIA does not anticipate that any such effects would be of a long term nature as it has alternative methods of deploying staff that do not involve the use of such suppliers. In the event that certain systems fail to function properly, manual processes will be implemented. Due to the nature of the business, PIA does not anticipate a system failure to cease the operations, as operations are not deemed to be systems dependent. Additionally, PIA plans to be capable of operating in the event of a systems failure of any vendor.

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PIA will utilize internal resources to reprogram, or replace and test the software for Year 2000 modifications. The total cost of the Year 2000 project is estimated at \$67,000 and is being funded through operating cash flows. Of the total project cost, approximately \$6,000 was expensed in the fiscal year 1998 and the remaining \$61,000 will be expensed in 1999. It is not expected that these costs will have a material effect on the results of operations.

The extent and magnitude of the Year 2000 problem as it will affect PIA externally, both before and after January 1, 2000, is difficult to predict or quantify for a number of reasons. These include the lack of control over systems that are used by third parties that are critical to PIA's operation, the complexity of testing inter-connected networks and applications that depend on third party networks. If any of these third parties experience Year 2000 problems, it could have a material adverse effect on PIA. Due to the nature of its business, however, PIA does not believe that its operations are dependent on third party systems. Furthermore PIA believes that manual processes could be implemented if certain systems failed to function properly.

PIA is not currently aware of any material operational issues associated with preparing its internal systems for the Year 2000, or the adequacy of critical third party systems. PIA has not developed a contingency plan in case it does not achieve Year 2000 compliance on or before December 31, 1999. The results of its evaluation and assessment efforts do not indicate a need for contingency planning. PIA intends to continue assessing its Year 2000 compliance, implementing compliance plans and communicating with third parties about their Year 2000 compliance. If PIA's continued efforts indicate that contingency planning is prudent, PIA will undertake appropriate planning at that time.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The Company is exposed to market risk related to the variable interest rate on the line of credit and the variable yield on its cash and cash equivalent. 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 long term debt.

The Company considers carrying amounts of current assets and liabilities in the consolidated financial statements to approximate the fair value for these financial instruments, because of the relatively short period of time between origination of the instruments and their expected realization. The carrying amounts of long-term debt approximate fair value because the obligation bears interest at a floating rate. The Company monitors the risks associated with interest rates and financial instrument positions based on policies set by arrangement card approved by the Board of Directors. The Company's investment policy objectives require the preservation and safety of the principal, sufficient liquidity to meet expected and unexpected cash requirements, and the maximization of the return on investment based upon the safety and liquidity objectives.

The Company's revenue derived from international operations is not material and, therefore, the risk related to foreign currency exchange rates is not material.

#### INVESTMENT PORTFOLIO

The Company has no derivative financial instruments or derivative commodity instruments in its cash and cash equivalents and investments. The Company invests its cash and cash equivalents in investments in high-quality and highly liquid investments consisting of taxable money market instruments, corporate bonds and some tax-exempt securities. The average yields on the Company's investments in the fiscal year ended January 1, 1999 were approximately 5.3% based on outstanding investments which ranged from \$8.2 million to \$13.0 million. The average yields on the Company's investments in the fiscal year ended December 31, 1997 were approximately 3.4% based on outstanding investments which ranged from \$11.1 million to \$22.8 million. As of January 1, 1999, PIA's cash and cash equivalents and investments totaled \$11.1 million and consisted primarily of taxable money market instruments, corporate bonds and tax-exempt securities with maturities of less than one year with an average yield of approximately 3.6%. As of December 31, 1997, PIA's cash and cash equivalents and investments totaled \$13.0 million and consisted primarily of taxable money market instruments, corporate bonds and tax-exempt securities with maturities of less than one year and with an average yield of approximately 5.1%. If there were a 10% change in the average yield based upon the Company's outstanding investments of \$11.1 million, interest income would increase or decrease by \$40,000 per annum.

#### DEBT

The Company obtained a line of credit with Mellon Bank N.A. in December 1998 and immediately drew down the minimum borrowing requirement of \$2.0 million, and had an outstanding balance of \$2.0 million at January 1, 1999. The line of credit requires monthly interest payments based on a variable interest rate applied to the outstanding loan balance. The weighted average interest rate on borrowings for the fiscal year ended January 1, 1999 was 8.0% and if there were a 10% change in the interest rate based upon the Company's minimum borrowing requirement of \$2.0 million interest expense would increase or decrease by \$16,000 per annum.

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

See Item 14 of this Annual Report on Form 10-K/A.

#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

#### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

##### DIRECTORS

Set forth in the table below is certain information concerning incumbent



directors and the nominees for election as directors of PIA. Ages are shown as of March 1, 1999. All of the incumbent directors are also nominees for the election as directors at PIA's 1999 Annual Meeting of Stockholders. Each nominee has consented to being named in this Form 10-K/A as a nominee for director and has agreed to serve as a director if elected. None of the nominees has any family relationship to any other nominee or to any executive officer of PIA. No arrangement or understanding exists between any nominee and any other person or persons pursuant to which any nominee was or is to be selected as a director or nominee other than with respect to Mr. Owens who has a contractual right to be nominated as a director as long as he holds at least 250,000 shares of PIA Common Stock. Mr. Owens has indicated that he will waive his contractual right to be nominated to the PIA Board if the merger (the "Merger") with SPAR Group is consummated. In connection with the consummation of the Merger, each of the nominees other than Messrs. Collins and Lewis has agreed to resign from the PIA Board, and Messrs. Collins and Lewis will fill three of the five remaining vacancies with the following persons designated by SPAR Group: Robert G. Brown (SPAR Group's Chairman, Chief Executive Officer and President), William H. Bartels (SPAR Group's Vice Chairman, Senior Vice President and Treasurer) and Robert O. Aders.

| NAME                   | Age | Position with PIA                               |
|------------------------|-----|---|
| Terry R. Peets         | 54  | Chief Executive Officer, President and Director |
| Patrick W. Collins(1)  | 70  | Director  |
| John A. Colwell        | 48  | Director  |
| Joseph H. Coulombe(2)  | 68  | Director  |
| Patrick C. Haden(1)(2) | 46  | Director  |
| J. Christopher Lewis   | 42  | Director  |
| Clinton E. Owens       | 57  | Chairman of the Board and Director              |

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- (1) Member of the Compensation Committee.
- (2) Member of the Audit Committee.

Set forth below is a brief description of the business experience for the previous five years of all nominees for directors of PIA.

Mr. Peets joined PIA in August 1997 as Chief Executive Officer, President and Director. Mr. Peets served as Executive Vice President of The Vons Companies, Inc. from 1995 to April 1997. Prior to joining Vons, Mr. Peets served in various sales, marketing and operation roles as Senior Vice President for Ralphs Grocery Company from 1977 to 1994, until he was named Executive Vice President in 1994. Mr. Peets also serves as a director of Supermarkets Online, a division of Catalina Marketing Corporation, a provider of in-store electronic marketing services and Diamond Brands, Inc., a manufacturer and marketer of branded household products.

Mr. Collins has been a member of the PIA Board since May 1998. Mr. Collins served as Chief Operating Officer of Ralphs Grocery Company for 18 years, 17 of which he served as President and one year as Vice Chairman. Mr. Collins also serves as a director of Catalina Marketing Corporation, a provider of in-store electronic marketing services, and New Bristol Farms, Inc., a gourmet food grocery chain.

Mr. Colwell has been a member of the PIA Board since March 1991, and currently serves as a consultant to PIA. From February 1997 through August 1997, Mr. Colwell served as interim Vice Chairman of the Board. Mr. Colwell is sole proprietor of a consulting and interim management firm bearing his name, and President of Facility Development Corporation. Since 1991, Mr. Colwell has served as a Managing Director of Lineberger & Co., a private equity investment

firm. From November 1991 through February 1997, Mr. Colwell was Senior Vice President of River City Plastics, Inc., a manufacturer of polyvinyl chloride pipe.

Mr. Coulombe has been a member of the PIA Board since May 1993. Mr. Coulombe is the founder and former Chief Executive Officer of Trader Joe's, a specialty food grocery chain. Mr. Coulombe sold Trader Joe's in 1979 and remained the Chief Executive Officer of Trader Joe's until January 1989. From February 1995 to April 1995, Mr. Coulombe served as President and Chief Executive Officer of Sport Chalet, and served as a director of Sport Chalet from February 1993 to June 1994. From February 1994 to January 1995, Mr. Coulombe served as Chief Executive Officer of Provigo Corp., the Northern California subsidiary of Provigo Inc., of Montreal. From June 1992 to January 1994, Mr. Coulombe served as a member of the Board of Directors of Imperial Bank, a subsidiary of Imperial Bancorp. Mr. Coulombe also serves as a director of Cost Plus World Market, a home furnishings store chain, and New Bristol Farms, Inc., a gourmet food grocery chain.

Mr. Haden became a member of the PIA Board in August 1988 in connection with PIA's acquisition. Since 1987, Mr. Haden has been a general partner of Riordan, Lewis & Haden (RLH), equity investors in California-based enterprises. RLH's portfolio interests emphasize high growth middle market companies, especially those in the value added service sector. Mr. Haden also serves as a director of Tetra Tech, Inc., an environmental engineering and consulting firm, Data Processing Resources Corporation, a provider of information technology specialty staffing services, and several privately-held companies.

Mr. Lewis has been a member of the PIA Board since April 1997. Since 1981, Mr. Lewis has been a general partner of Riordan, Lewis & Haden. Mr. Lewis also serves as a director of Tetra Tech, Inc., Data Processing Resources Corporation, SM&A Corporation, California Beach Restaurants, Inc., an owner and operator of restaurants, and several privately-held companies.

Mr. Owens has been Chairman of PIA since August 1988 and served as Chief Executive Officer of PIA from August 1988 to August 1997. Mr. Owens has over 30 years experience in the merchandising services and packaged goods industries. Mr. Owens previously has served as Senior Vice President of Sales and Marketing of Coca Cola Foods, and has also served in various management positions with RJR Foods and Procter & Gamble, among others.

#### DIRECTOR MEETINGS AND COMMITTEES

During fiscal 1998, the PIA Board held nine meetings and took various actions by written consent. Each incumbent director attended at least 75% of the aggregate of (i) the total number of meetings held by the PIA Board during fiscal 1998 and (ii) the total number of meetings held by all committees of the PIA Board during that period within which he was a Director or member of such committee of the PIA Board.

The standing committees of the PIA Board are the Audit Committee (the "Audit Committee") and the Compensation Committee (the "Compensation Committee"). The Audit Committee held two meetings and the Compensation Committee held one meeting during fiscal 1998. PIA does not have a standing nominating committee or any committee performing the functions thereof.

The Audit Committee presently consists of Messrs. Haden and Coulombe. The Audit Committee makes recommendations concerning the engagement of independent public accountants; reviews with the independent public accountants the plans for and scope of the audit, reviews the results of the audit; approves the professional services provided by the independent public accountants; reviews the independence of the public accountants; and reviews the adequacy and effectiveness of PIA's internal accounting control.

The Compensation Committee presently consists of Messrs. Haden and Collins. The Compensation Committee determines compensation for PIA's executive officers and administers PIA's stock incentive plans.

#### EXECUTIVE OFFICERS

Set forth in the table below are the names, ages and positions of the current executive officers of PIA. Ages are shown as of March 1, 1999. Executive officers are elected by and serve at the discretion of the PIA Board. None of the executive officers has any family relationship to any nominee for director or to any other executive officer of PIA.

| NAME             | Age | Position with PIA   |
|------------------|-----|---|
| Clinton E. Owens | 57  | Chairman of the Board and Director                              |
| Terry R. Peets   | 54  | Chief Executive Officer, President and Director                 |
| Cathy L. Wood    | 51  | Executive Vice President, Chief Financial Officer and Secretary |
| Donald H. Holman | 42  | Executive Vice President-- Marketing and Sales                  |
| John R. Bain     | 52  | Executive Vice President-- Operations                           |
| Mark J. Hallsman | 44  | Senior Vice President-- Field Logistics and Operations Planning |

Set forth below is a brief description of the business experience for the previous five years of all current executive officers of PIA except Messrs. Peets and Owens whose business experience has been previously described. In connection with the consummation of the Merger, each of the above executive officers has agreed to resign other than Ms. Wood who will remain in her current position and Mr. Peets who will become Vice Chairman of PIA. If the Merger is consummated, the other executive officers of PIA will be as follows: Mr. Brown, Chairman, Chief Executive Officer and President, Mr. Bartels, Vice Chairman and James R. Ross, Treasurer.

Ms. Wood joined PIA in August 1997 as Executive Vice President, Chief Financial Officer and Secretary. Ms. Wood served as Vice President and Chief Financial Officer of Giant Group Ltd., a NYSE listed company specializing in acquisitions, from 1995 to 1997. From 1989 to 1995, Ms. Wood served in various capacities at Warehouse Entertainment, Inc. prior to being named Senior Vice President and Chief Financial Officer in 1993. From 1972 to 1989, Ms. Wood served in various credit and lending positions at Mellon Bank, N.A., including from 1982 to 1989, Vice President of Consumer Products and Retail Credit Analysis.

Mr. Holman joined PIA in June 1992 and has served as Executive Vice President of Marketing and Sales since August 1998. From June 1996 to August 1998, Mr. Holman served as PIA's Vice President of Sales. From January 1995 to June 1996, Mr. Holman served as PIA's Vice President of Business Development and from June 1992 to December 1994, Mr. Holman served as PIA's Vice President Division Manager.

Mr. Bain joined PIA in November 1997 as Senior Vice President of Operations and became Executive Vice President of Operations in August 1998. Mr. Bain served as Executive Vice President of Shasta Beverages in the Western Division from October 1995 to November 1997. Before joining Shasta Beverages, Mr. Bain served as Vice President of Sales and Marketing for Casablanca Food Company, and Divisional Vice President for Continental Baking Company, from 1992 to 1994.

Mr. Hallsman joined PIA in August 1993 and has served as Senior Vice President of Field Logistics and Operations Planning since August 1998. From December 1995 to August 1998, Mr. Hallsman served as PIA's Senior Vice President of Human Resources and from August 1993 to December 1995, Mr. Hallsman served as Vice President of Human Resources. From September 1985 to August 1993, Mr. Hallsman served as Director, Human Resources of Con-Way Western Express, a provider of short-haul trucking services.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act ("Section 16(a)") requires PIA's directors and certain of its officers and persons who own more than 10% of PIA

Common Stock (collectively, "Insiders"), to file reports of ownership and changes in their ownership of PIA Common Stock with the Commission. Insiders are required by Commission regulations to furnish PIA with copies of all Section 16(a) forms they file.

Based solely on its review of the copies of such forms received by it, or written representations from certain reporting persons that no Forms 5s were required for those persons, PIA believes that its Insiders complied with all applicable Section 16(a) filing requirements for fiscal 1998, with the exception of Messrs. Bain, Colwell, Haden, Holman, Lewis, Owens and Peets and Ms. Wood, each of which filed a late Form 5 reporting one transaction and Mr. Coulombe who filed a late Form 5 reporting two transactions.

ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth all compensation received for services rendered to PIA in all capacities for the three fiscal years ended January 1, 1999 by (i) PIA's Chief Executive Officer during fiscal 1998, and (ii) each of the other four most highly compensated executive officers of PIA who were serving as executive officers at the end of fiscal 1998 (collectively, the "Named Executive Officers"):

SUMMARY COMPENSATION TABLE

| NAME AND PRINCIPAL POSITIONS   | FISCAL YEAR | ANNUAL COMPENSATION |                | LONG TERM COMPENSATION AWARDS     | ALL OTHER COMPENSATION (\$ (2)) |
|--|-------------|---------------------|----------------|-----------------------------------|---------------------------------|
|  |             | SALARY (\$) (1)     | BONUS (\$) (1) | SECURITIES UNDERLYING OPTIONS (#) |                                 |
| Terry R. Peets<br>President and Chief Executive Officer                          | 1998        | \$ 253,894          | \$ --          | 35,000                            | \$ 7,667                        |
|  | 1997        | 111,757             | --             | 250,000                           | 10,675                          |
|  | 1996        | --                  | --             | --                                | --                              |
| Clinton E. Owens<br>Chairman of the Board  | 1998        | 340,833             | --             | --                                | 13,442                          |
|  | 1997        | 400,000             | --             | --                                | 34,557                          |
|  | 1996        | 400,000             | 50,000         | --                                | 36,820                          |
| Cathy L. Wood<br>Executive Vice President, Chief Financial Officer and Secretary | 1998        | 202,366             | --             | 65,000                            | --                              |
|  | 1997        | 96,692              | --             | 100,000                           | --                              |
|  | 1996        | --                  | --             | --                                | --                              |
| John R. Bain<br>Executive Vice President-- Operations                            | 1998        | 160,625             | --             | 45,000                            | 2,463                           |
|  | 1997        | 18,750              | --             | 25,000                            | --                              |
|  | 1996        | --                  | --             | --                                | --                              |
| Donald H. Holman<br>Executive Vice President-- Marketing and Sales               | 1998        | 168,317             | --             | 52,500                            | 2,966                           |
|  | 1997        | 120,118             | --             | 15,000                            | 2,434                           |
|  | 1996        | 107,056             | 9,000          | 10,000                            | 2,174                           |

(1) For the year ended December 31, 1996, includes \$109,500 and \$4,347 deferred at the election of Messrs. Owens and Holman, respectively; for the year ended December 31, 1997, includes \$2,500, \$95,833 and \$4,867, deferred at the election of Messrs. Peets, Owens and Holman, respectively; and for the year ended January 1, 1999, includes \$10,000, \$8,802, \$9,850 and \$5,933, deferred at the election of Messrs. Peets, Owens, Bain and Holman, respectively; pursuant

to PIA's 401(k) Plan and Deferred Compensation Arrangement. See "-- Compensation Plans -- 401(k) Plan" and "-- Deferred Compensation Arrangement."

(2) Consists of contributions to the 401(k) Plan made by PIA on behalf of each of Messrs. Peets, Owens, Bain and Holman, respectively. Also includes an aggregate of \$4,236 and \$2,630 in insurance premiums paid by PIA on behalf of Mr. Peets during the years ended December 31, 1997 and January 1, 1999, respectively, for certain life insurance and disability insurance policies of which Mr. Peets is the sole beneficiary. Also includes an aggregate of

\$29,820, \$14,891 and \$9,145 in insurance premiums paid by PIA on behalf of Mr. Owens during the years ended December 31, 1996, December 31, 1997 and January 1, 1999, respectively, for certain life and disability insurance policies of which Mr. Owens is the sole beneficiary.

#### EMPLOYMENT AGREEMENTS, SEVERANCE ARRANGEMENTS AND CHANGE IN CONTROL ARRANGEMENTS

Mr. Peets entered into an at will employment agreement with PIA on June 25, 1997. Such agreement is terminable by PIA at any time, subject to, among other things, severance payments as provided in the employment agreement. From June 25, 1997 through August 9, 1997, Mr. Peets received a salary of \$1,200 per day and from August 10, 1997 to August 9, 1998 he received a salary of \$20,834 per month. Mr. Peets' employment agreement was amended on October 1, 1998 whereby effective August 10, 1998, Mr. Peets receives a salary of \$21,459 per month, subject to annual review by the PIA Board for possible increases, with a minimum increase tied to the Los Angeles-Long Beach-Anaheim consumer price index. Mr. Peets is also entitled to a yearly bonus of up to 100% of his base salary based upon PIA achieving certain operating results. PIA's obligation to pay a pro-rated bonus to Mr. Peets upon an acquisition event (such term, as defined in his employment agreement, includes the consummation of the Merger) is contingent on PIA achieving certain operating results prior to such event. It is currently anticipated that no bonus will be payable to Mr. Peets in connection with the consummation of the Merger. The employment agreement also provides for payment of Mr. Peets' salary for 18 months if PIA terminates his employment without cause (as defined in his employment agreement) during the two year period following a material corporate event (which term, as defined in his employment agreement, includes the consummation of the Merger) or if Mr. Peets terminates his employment for material reason (as defined in his employment agreement) within one year following such event. His employment agreement further provides that the vesting schedule for Mr. Peets' unvested options (222,500 at January 1, 1999) be accelerated by two years upon the occurrence of an acquisition event. Mr. Peets' employment agreement was amended further to provide that his consent to certain actions taken by PIA following the Merger, including the change in Mr. Peets' title, will not require him to waive his right to resign for material reason, nor will he be deemed to have waived such right.

Mr. Owens entered into an agreement with PIA on August 10, 1998 that settles all differences arising out of or relating to Mr. Owen's employment with PIA. Pursuant to the agreement, Mr. Owens resigned as an employee of PIA and all its subsidiaries effective November 10, 1998 but continues to serve as Chairman of the Board and a director of PIA. The agreement provides, among other things, for severance payments of \$37,500 per month for a period of nine months following the date of his resignation as an employee. In addition, under the terms of the agreement, Mr. Owens has the right to be nominated to serve on the PIA Board as long as he holds at least 250,000 shares of PIA Common Stock. Mr. Owens has indicated that he will waive this right in connection with the Merger.

Ms. Wood entered into a severance agreement with PIA on February 20, 1998 which was amended and restated on October 1, 1998. Ms. Wood or PIA may terminate the agreement at any time. The agreement provides, among other things, for payment of Ms. Wood's salary for 18 months if PIA terminates her employment without cause (as defined in Ms. Wood's severance agreement) during the two year period following a change of control (such term, as defined in her severance agreement, includes the consummation of the Merger) or if Ms. Wood terminates her employment for good reason (as defined in her severance agreement) within one year following such event. The agreement further provides that the vesting schedule for her unvested stock options (140,000 at January 1, 1999) shall be accelerated by two years upon the occurrence of a change of control of PIA (which includes the Merger). Ms. Wood's agreement was further amended to provide that her consent to certain actions by PIA following the Merger will not require her to waive her right to resign for good reason, nor will she be deemed to have waived such right.

PIA currently has no written employment or severance contracts with any of the Named Executive Officers other than as described above.

Messrs. Bain, Holman and Hallsman are entitled to receive severance payments pursuant to PIA's severance policy. Messrs. Bain and Holman will

receive their salary for 12 months and Mr. Hallsman will receive his salary for nine months if they are terminated without cause within two years following a material corporate event (such term, as defined by the PIA Board, includes the consummation of the Merger). In addition, pursuant to action taken by the PIA Board, all of the unvested options held by each executive officer of PIA will be automatically vested in full if such executive officer is terminated without cause within two years following a material corporate event. The vesting schedule for such options will be accelerated by two years upon the occurrence of an acquisition event (such term, as defined by the PIA Board, includes the consummation of the Merger).

STOCK OPTION GRANTS IN LAST FISCAL YEAR

The following table sets forth information regarding each grant of stock options made during the year ended January 1, 1999 to each of the Named Executive Officers. No stock appreciation rights ("SARs") were granted during such period to such persons.

| NAME             | INDIVIDUAL GRANTS (1)                               |   |                        |                 | POTENTIAL REALIZABLE VALUE AT ASSUMED ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION(2) |          |
|------------------|---|---|------------------------|-----------------|--|----------|
|                  | NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED (#) | PERCENT OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN PERIOD (%) | EXERCISE PRICE (\$/SH) | EXPIRATION DATE |  |          |
|                  |   |   |                        |                 | 5% (\$)  | 10% (\$) |
| Terry R. Peets   | 35,000  | 10.2  | 4.500                  | 09/21/08        | 99,051   | 251,014  |
| Clinton E. Owens | --  | --  | --                     | --              | --   | --       |
| Cathy L. Wood    | 50,000  | 14.5  | 5.870                  | 08/02/08        | 168,765  | 428,068  |
|                  | 15,000  | 4.4   | 4.500                  | 09/21/08        | 42,450   | 107,578  |
| John R. Bain     | 10,000  | 2.9   | 4.875                  | 04/07/08        | 30,659   | 77,695   |
|                  | 35,000  | 10.2  | 6.250                  | 08/12/08        | 137,571  | 348,631  |
| Donald H. Holman | 10,000  | 2.9   | 4.875                  | 04/07/08        | 30,659   | 77,695   |
|                  | 32,500  | 9.4   | 6.250                  | 08/12/08        | 127,744  | 323,729  |
|                  | 10,000  | 2.9   | 4.000                  | 10/28/08        | 25,156   | 63,750   |

- (1) All such options vest over four year periods at an annual rate of 25% beginning on the first anniversary of the date of grant. Notwithstanding the foregoing, the vesting schedule for all such options will accelerate by two years upon the occurrence of an acquisition event (such as the Merger) and all such options will be fully vested for any officer who is terminated without cause within two years following an acquisition event.
- (2) The potential realizable value is calculated based on the term of the option (ten years) at its time of grant. It is calculated by assuming that the stock price on the date of grant appreciates at the indicated annual rate, compounded annually for the entire term of the option.

AGGREGATED STOCK OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR END OPTION VALUES

The following table sets forth the number and value of the exercisable and unexercisable options held by each of the Named Executive Officers at January 1, 1999. None of the Named Executive Officers exercised any options during the fiscal year ended January 1, 1999.

| NAME             | NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT FISCAL YEAR-END (#) |               | VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT FISCAL YEAR-END (\$) (1) |               |
|------------------|--|---------------|---|---------------|
|                  | EXERCISABLE  | UNEXERCISABLE | EXERCISABLE   | UNEXERCISABLE |
| Terry R. Peets   | 62,500   | 222,500       | 0   | 0             |
| Clinton E. Owens | 227,026  | --            | 0   | 0             |
| Cathy L. Wood    | 25,000   | 140,000       | 0   | 0             |

|                  |        |        |   |   |
|------------------|--------|--------|---|---|
| John R. Bain     | 6,250  | 63,750 | 0 | 0 |
| Donald H. Holman | 11,182 | 68,750 | 0 | 0 |

(1) All options held by PIA Named Executive Officers were out of the money at January 1, 1999. As of the year ended January 1, 1999 the fair market value of PIA Common Stock (as reported by the Nasdaq National Market) was \$2.50 which was less than the exercise price of the outstanding options.

COMPENSATION PLANS

1990 Stock Option Plan. In June 1990, PIA adopted a stock incentive plan (as amended, the "1990 Option Plan"), covering 810,811 shares of PIA Common Stock that may be granted to certain employees and directors to help them to acquire shares of PIA Common Stock and thereby benefit directly from PIA's growth, development and financial success. As of January 1, 1999, there were 393,031 options outstanding under the 1990 Option Plan at a weighted average exercise price of \$6.11 per share, and 95,814 shares of PIA Common Stock had been issued upon exercise of options at a weighted average price of \$5.10 per share. In December 1995, the PIA Board determined that no further option grants would be made under the 1990 Option Plan.

The 1990 Option Plan is administered by PIA's Compensation Committee. Officers, key employees, consultants and directors of PIA and its subsidiaries are eligible to receive grants under the 1990 Option Plan. Stock options granted under the 1990 Option Plan are priced at no less than 85% of the fair market value of the PIA Common Stock on the date of the grant.

1995 Option Plan. In December 1995, PIA adopted the 1995 Option Plan. The 1995 Option Plan currently covers 1,300,000 shares of PIA Common Stock that may be granted to certain employees, directors, consultants and other persons providing valuable services to PIA. In connection with the consummation of the Merger, PIA will increase the number of shares under the 1995 Option Plan to 3,500,000. As of January 1, 1999, there were 1,016,254 options outstanding under the 1995 Option Plan at a weighted average exercise price of \$5.69 per share, and 2,000 shares of PIA Common Stock had been issued upon exercise of options at a weighted average price of \$9.87 per share.

The 1995 Option Plan is administered by PIA's Compensation Committee. Officers, certain directors, key employees and consultants of PIA and its subsidiaries are eligible to receive grants under the 1995 Option Plan. In February 1999, PIA approved the amendment and restatement of the 1995 Option Plan to provide that, among other things, grants may also be made to other persons providing valuable services to PIA. Stock options granted under the 1995 Option Plan are priced at not less than the fair market value of the PIA Common Stock on the date of grant.

1995 Stock Option Plan for Nonemployee Directors. PIA adopted its 1995 Stock Option Plan for Nonemployee Directors in December 1995 (the "Nonemployee Directors Plan"), covering 100,000 shares of PIA Common Stock. Under the Nonemployee Directors Plan, each of Messrs. Coulombe, Haden and Lewis was granted an option to purchase 1,500 shares of PIA Common Stock at an exercise price of \$5.32 per share that became fully exercisable on May 12, 1998. Messrs. Colwell, Coulombe, Haden and Lewis were each granted an option to purchase 1,500 shares of PIA Common Stock at an exercise price of \$5.125 per share on May 12, 1998, that will become fully exercisable on the date of the Annual Meeting if they serve as a director until the date of the Annual Meeting. Notwithstanding the foregoing, pursuant to action taken by the PIA Board in February 1999, all options granted to nonemployee directors will automatically vest in full upon the occurrence of an acquisition event (such term, as defined by the PIA Board, includes the consummation of the Merger).

PIA's Compensation Committee administers the Nonemployee Directors Plan. Each member of the PIA Board who is not otherwise an employee or officer of PIA or any subsidiary of PIA (each, an "Eligible Director") is eligible to participate in the Nonemployee Directors Plan. Directors who are consultants of, but not otherwise employees or officers of, PIA are Eligible Directors.

Special Purpose Stock Option Plan. In February 1999, PIA adopted the Special Purpose Stock Option Plan (the "Special Plan") to provide solely for the issuance of PIA options ("Substitute Options") to holders of SPAR Group options in exchange for such SPAR Group options in connection with the Merger. The Special Plan is administered by the PIA Board. All available options to acquire stock under the Special Plan will be granted at the effective time of the Merger and no further Substitute Options may be granted under the Special Plan.

Employee Stock Purchase Plan. On February 17, 1997, PIA adopted an Employee Stock Purchase Plan ("ESP Plan"). The ESP Plan allows employees of PIA to purchase PIA Common Stock at a discount, without having to pay any commissions on the purchases. The maximum amount that any employee can contribute to the ESP Plan per quarter is \$6,250, and the total number of shares which are reserved by PIA for purchase under the ESP Plan is 200,000. As of January 1, 1999, 12,290 shares of PIA Common Stock had been issued at a weighted average price of \$3.69 per share.

401(k) Plan. The PIA Savings and Retirement 401(k) Plan (the "401(k) Plan") covers all PIA employees that do not participate in the pension plans described below. An employee may elect to defer, in the form of Company contributions to the 401(k) Plan on his or her behalf, up to 15% of the total compensation that would otherwise be paid to the employee, not to exceed the amount allowed by applicable IRS guidelines. In addition, PIA makes matching contributions to the 401(k) Plan each year equal to 50% of the participant's elective contributions (not to exceed 4% of the total compensation) for such year, and may also make additional contributions to the 401(k) Plan for one or more plan years to be allocated to eligible participants in proportion to their total compensation (including deferred salary contributions) for the year. Contributions are allocated to each employee's individual account and are invested in a variety of mutual funds according to the directions of the employee. Employee contributions are fully vested and non-forfeitable at all times. Company matching contributions vest over five years.

Deferred Compensation Arrangement. The Deferred Compensation Arrangement (the "DCA") permits a certain group of highly compensated employees who are designated by the PIA Board to defer the receipt of some or all of their compensation until a subsequent year. Participants are not subject to income tax on the amount of their contributions to the DCA ("Deferrals"), but those amounts are subject to federal employment taxes. PIA will generally make matching contributions on behalf of the contributions made by participants to the DCA and participants will gain a vested interest in the matching contributions, to the same extent as under the 401(k) Plan. Participants always have a fully vested right to their Deferrals. Although no amounts are set aside by PIA to pay the benefits under the DCA, a trust has been established to "informally" fund the benefits under the DCA. Participants can direct the manner in which the amounts held on their behalf under the DCA are invested. Although the DCA is not a tax-qualified retirement plan, under certain circumstances, a participant's Deferrals may be transferred to the 401(k) Plan. A participant's benefit under the DCA will be paid in either a lump sum or in installments, as elected by the participant.

Exec-U-Care Plan. Under the Exec-U-Care Plan (the "Exec-U-Care Plan"), PIA provides the Chairman and certain other officers of PIA up to \$100,000 supplemental medical coverage in addition to the standard medical coverage generally offered to such persons by PIA. The Exec-U-Care Plan requires that the employees covered thereunder have a primary medical insurance plan which meets certain minimum standards of coverage; the Exec-U-Care Plan then covers the deductible and certain other expenses not paid for by the basic medical insurance plan.

Pension Plans. Certain of PIA's employees are covered by union-sponsored, collectively bargained, multi-employer pension plans. PIA has no current intention of withdrawing from any of these plans.

Incentive Compensation Plan. For 1998, the Compensation Committee approved the 1998 Incentive Compensation Plan (the "ICP") which is based upon PIA's 1998 Business Plan (the "Business Plan"). Under the ICP, specified bonuses would have been payable in the event PIA's earnings per share equaled or exceeded a specified target amount. No bonuses were paid to executive officers in 1998 and the ICP was terminated.



## COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

No member of the Compensation Committee was at any time during the year ended January 1, 1999 or at any other time an officer or employee of PIA. No executive officer of PIA serves as a member of the PIA Board or compensation committee of any other entity, which has one or more executive officers serving as a member of the PIA Board or Compensation Committee.

## LIMITATION OF LIABILITY AND INDEMNIFICATION MATTERS

PIA's Certificate of Incorporation limits the liability of directors to the maximum extent permitted by Delaware law. Delaware law provides that directors of a company will not be personally liable for monetary damages for breach of their fiduciary duties as directors, except for liability (i) for any breach of their duty of loyalty to the company or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) for unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 174 of the Delaware General Corporation Law, or (iv) for any transaction from which the director derived an improper personal benefit. Pursuant to the merger agreement governing the Merger of SPAR Group and PIA (the "Merger Agreement"), if the Merger is consummated, SPAR and PIA have agreed not to amend such provisions limiting personal liability in PIA's charter documents for six years following the Merger.

PIA's bylaws provide that PIA may indemnify its officers, directors, employees and other agents to the fullest extent permitted by law. Pursuant to the Merger Agreement, if the Merger is consummated, PIA and SPAR Group have agreed to indemnify to the fullest extent permitted by law (i) each of the seven nominees for director of PIA, (ii) each person who has served as a director of PIA prior to February 28, 1999, and (iii) each officer holding a title of Senior Vice President or higher with PIA, PIA Co. or any of PIA Co.'s subsidiaries as of February 28, 1999 for six years following the consummation of the Merger. PIA's bylaws also permit it to secure insurance on behalf of any officer, director, employee or other agent for any liability arising out of his or her actions in such capacity, regardless of whether the bylaws would permit indemnification. PIA currently maintains such insurance and PIA and SPAR Group have also agreed to maintain PIA's current directors' and officers' liability insurance for PIA as in effect on the closing date of the Merger for six years following the Merger.

At present, there is no pending litigation or proceeding involving any director, officer, employee or agent of PIA in which indemnification will be required or permitted. PIA is not aware of any threatened litigation or proceeding which may result in a claim for such indemnification.

## DIRECTOR COMPENSATION

During the year ended January 1, 1999, PIA paid to Messrs. Coulombe and Edwin Epstein, a former director, an aggregate of \$10,500 and \$15,750, respectively, for services as members of the PIA Board and as consultants, and also reimbursed Messrs. Coulombe and Epstein for certain expenses in connection with their attendance at PIA Board and committee meetings. Messrs. Haden and Lewis received no compensation for their services as directors (other than the grant of options as described in the following paragraphs). Commencing April 1, 1998, Mr. Colwell receives an annual salary of \$50,000 for consulting services. Mr. Colwell is also entitled to receive a success fee in the event certain transactions (approximately \$150,000 in connection with the Merger) are completed by PIA. Prior to April 1, 1998, Mr. Colwell received a monthly salary of \$16,667 for his services as a director. During fiscal 1998, PIA paid Mr. Colwell an aggregate of \$120,790 for his services as a member of the PIA Board and consultant, and also reimbursed Mr. Colwell for certain expenses in connection with his attendance at PIA Board meetings. In addition, beginning in April 1998, Messrs. Collins and Coulombe receive a \$3,000 fee for regular meetings (up to a maximum of four meetings) and a \$500 fee for special meetings (including telephonic meetings). Mr. Collins deferred receipt of his

compensation until January 1999.

Under the 1995 Option Plan, on April 8, 1998, PIA granted Messrs. Collins and Coulombe an option to purchase 10,000 shares and 4,000 shares, respectively, of PIA Common Stock at an exercise price of \$4.875 per share. Such options vest over four years at an annual rate of 25% beginning on the first anniversary of the date of grant, provided that such option will automatically vest in full upon the consummation of the Merger or another acquisition event as described in the following paragraph.

1995 Stock Option Plan for Nonemployee Directors. PIA adopted its 1995 Stock Option Plan for Nonemployee Directors in December 1995 (the "Nonemployee Directors Plan"), covering 100,000 shares of PIA Common Stock. Under the Nonemployee Directors Plan, each of Messrs. Coulombe, Haden and Lewis was granted an option to purchase 1,500 shares of PIA Common Stock at an exercise price of \$5.32 per share that became fully exercisable on May 12, 1998. Messrs. Colwell, Coulombe, Haden and Lewis were each granted an option to purchase 1,500 shares of PIA Common Stock at an exercise price of \$5.125 per share on May 12, 1998, that will become fully exercisable on the date of PIA's 1999 Annual Meeting of Stockholders if they are reelected as a director. Notwithstanding the foregoing, pursuant to action taken by the PIA Board in February 1999, all options granted to nonemployee directors will automatically vest in full upon the occurrence of an acquisition event (such term, as defined by the PIA Board, includes the consummation of the Merger).

PIA's Compensation Committee administers the Nonemployee Directors Plan. Each member of the PIA Board who is not otherwise an employee or officer of PIA or any subsidiary of PIA (each, an "Eligible Director") is eligible to participate in the Nonemployee Directors Plan. Directors who are consultants of, but not otherwise employees or officers of, PIA are Eligible Directors.

Under the Nonemployee Directors Plan, an option to purchase 1,500 shares of PIA Common Stock is granted to each Eligible Director immediately following each annual meeting of stockholders of PIA. Each option vests and becomes exercisable in full at the next annual meeting of stockholders, provided that the optionee is reelected as a director of PIA. The maximum term of options granted under the Nonemployee Directors Plan is ten years and one day, subject to earlier termination following an optionee's cessation of service with PIA. The exercise price of stock options granted under the Nonemployee Directors Plan will be the fair market value of the PIA Common Stock on the date of grant.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding beneficial ownership of the PIA Common Stock as of March 1, 1999 by: (i) each person (or group of affiliated persons) who is known by PIA to own beneficially more than 5% of PIA Common Stock; (ii) each of PIA's directors; (iii) each of the Named Executive Officers; and (iv) PIA's directors and executive officers as a group. Except as indicated in the footnotes to this table, the persons named in the table, based on information provided by such persons, have sole voting and sole investment power with respect to all shares of PIA Common Stock shown as beneficially owned by them, subject to community property laws where applicable. The proposed Merger with SPAR Group will, if consummated, result in a change in control of PIA.

| NAME AND ADDRESS OF BENEFICIAL OWNER<br>-----  | NUMBER OF SHARES<br>BENEFICIALLY OWNED<br>----- | PERCENTAGE<br>----- |
|--|---|---------------------|
| Riordan, Lewis & Haden (1)<br>300 S. Grand Avenue, 29th Floor<br>Los Angeles, California 90071 | 1,637,151 (2)                                   | 29.7%               |

Clinton E. Owens (3)

615,802(4)

11.0

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| NAME AND ADDRESS OF BENEFICIAL OWNER<br>-----   | NUMBER OF SHARES<br>BENEFICIALLY OWNED<br>----- | PERCENTAGE<br>----- |
|---|---|---------------------|
| Heartland Advisors, Inc.<br>790 North Milwaukee Street<br>Milwaukee, Wisconsin 53202                | 1,423,800(5)                                    | 26.0                |
| California Community Foundation<br>606 S. Olive Street, Suite 2400<br>Los Angeles, California 90014 | 480,872(6)                                      | 8.7                 |
| Terry R. Peets (3)  | 102,500(7)                                      | 2.0                 |
| Cathy L. Wood (3)   | 26,000(8)                                       | *                   |
| Donald H. Holman (3)  | 18,594(9)                                       | *                   |
| John R. Bain (3)  | 8,750(10)                                       | *                   |
| Patrick W. Collins (3)  | 2,500(11)                                       | *                   |
| John A. Colwell (3)   | 67,011(12)                                      | 1.2                 |
| Joseph H. Coulombe (3)  | 18,310(13)                                      | *                   |
| Patrick C. Haden<br>300 S. Grand Avenue, 29th Floor<br>Los Angeles, California 90071                | 1,641,151(14)                                   | 29.8                |
| J. Christopher Lewis<br>300 S. Grand Avenue, 29th Floor<br>Los Angeles, California 90071            | 1,641,151(15)                                   | 29.8                |
| All directors and executive officers as a group (11<br>persons)                                     | 2,531,899                                       | 43.3%               |

\* Less than 1%.

- (1) Shares are owned by RVM/PIA, a California limited partnership managed by Riordan, Lewis & Haden ("RLH").
- (2) Includes 29,729 shares issuable upon exercise of certain warrants to purchase PIA Common Stock owned by RLH.
- (3) The address of such persons is c/o PIA Merchandising Services, Inc., 19900 MacArthur Boulevard, Suite 900, Irvine, California 92718.
- (4) Includes 498,394 shares held by Clinton E. and Mary Ann Owens as Trustees of The Owens Family Trust dated June 20, 1994, 9,300 shares held by Clinton E. Owens as Trustee of the Welch Trust for Marcia

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Browning and 108,108 shares issuable upon the exercise of options which are

exercisable as of, or will become exercisable within 60 days of, March 1, 1999.

- (5) All information regarding share ownership is taken from and furnished in reliance upon the Schedule 13G (Amendment No. 4), dated January 28, 1999, filed by Heartland Advisors, Inc. with the Securities and Exchange Commission on February 2, 1999.
- (6) All information regarding share ownership is taken from and furnished in reliance upon Schedule 13G (Amendment No. 2), dated February 12, 1999, filed by California Community Foundation with the Securities and Exchange Commission on February 12, 1999. Includes 66,666 shares issuable upon exercise of a warrant to purchase PIA Common Stock.
- (7) Includes 62,500 shares issuable upon the exercise of options which are exercisable as of, or will become exercisable within 60 days of, March 1, 1999.
- (8) Includes 25,000 shares issuable upon the exercise of options which are exercisable as of, or will become exercisable within 60 days of, March 1, 1999.
- (9) Includes 17,432 shares issuable upon the exercise of options which are exercisable as of, or will become exercisable within 60 days of, March 1, 1999.
- (10) Includes 8,750 shares issuable upon the exercise of options which are exercisable as of, or will become exercisable within 60 days of, March 1, 1999.
- (11) Includes 2,500 shares issuable upon the exercise of options which are exercisable as of, or will become exercisable within 60 days of, March 1, 1999.
- (12) Includes 64,206 shares issuable upon the exercise of options which are exercisable as of, or will become exercisable within 60 days of, March 1, 1999.
- (13) Includes 6,905 shares held by Joseph H. Coulombe as Trustee of The Coulombe Family Trust dated July 26, 1980 and 11,405 shares issuable upon the exercise of options which are exercisable as of, or will become exercisable within 60 days of, March 1, 1999.
- (14) Includes 1,637,151 shares (including 29,729 shares issuable upon exercise of warrants) owned by RLH. Mr. Haden, a director of PIA, may be deemed to share voting and investment power with respect to all such shares as a general partner of RLH. No other person, other than J. Christopher Lewis, a director of PIA, has voting power or investment power with respect to such shares. Also includes 4,000 shares issuable upon the exercise of options held by Mr. Haden which are exercisable as of, or will become exercisable within 60 days of, March 1, 1999.
- (15) Includes 1,637,151 shares (including 29,729 shares issuable upon exercise of warrants) owned by RLH. Mr. Lewis, a director of PIA, may be deemed to share voting and investment power with respect to all such shares as a general partner of RLH. No other person, other than Patrick C. Haden, a director of PIA, has voting power or investment power with respect to such shares. Also includes 4,000 shares issuable upon the exercise of options held by Mr. Lewis which are exercisable as of, or will become exercisable within 60 days of, March 1, 1999.

Immediately following the Merger and assuming full exercise of all Substitute Options, the holders of SPAR Group stock and the holders of Substitute Options (assuming full exercise thereof) will hold an aggregate of

approximately 69.3% of PIA Common Stock then outstanding and the holders of PIA Common Stock immediately prior to the Merger will hold approximately 30.7% of the PIA Common Stock then outstanding.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

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PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) 1. INDEX TO FINANCIAL STATEMENTS FILED AS PART OF THIS REPORT:

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|--|-----|
| Independent Auditors' Report   | F-1 |
| Consolidated Balance Sheets as of December 31, 1997 and January 1, 1999                                    | F-2 |
| Consolidated Statements of Operations for the three years<br>in the period ended January 1, 1999           | F-4 |
| Consolidated Statements of Stockholders' Equity for the three years<br>in the period ended January 1, 1999 | F-5 |
| Consolidated Statements of Cash Flows for the three years in the period<br>ended January 1, 1999           | F-6 |
| Notes to Consolidated Financial Statements for the three years<br>in the period ended January 1, 1999      | F-8 |

2. FINANCIAL STATEMENT SCHEDULES.

|  |      |
|--|------|
| Schedule II - Valuation and Qualifying Accounts for the three years in<br>the period ended January 1, 1999 | F-25 |
|--|------|

3. EXHIBITS.

EXHIBIT

NUMBER

DESCRIPTION

- - - - -

- - - - -

|        |   |
|--------|---|
| 3.1    | Certificate of Incorporation of PIA (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 33-80429) as filed with the Securities and Exchange Commission on December 14, 1995 (the "Form S-1"))            |
| 3.2    | By-laws of PIA (incorporated by reference to the Form S-1).   |
| 4.1    | Registration Rights Agreement entered into as of January 21, 1992 by and between RVM Holding Corporation, RVM/PIA, a California Limited Partnership, The Riordan Foundation and Creditanstalt-Bankverein (incorporated by reference to the Form S-1). |
| 10.1   | 1990 Stock Option Plan (incorporated by reference to the Form S-1).   |
| 10.2   | Amended and Restated 1995 Stock Option Plan (incorporated by reference of Exhibit 10.2 to the Company's Form 10-Q for the 2nd Quarter ended July 3, 1998).  |
| 10.3   | 1995 Stock Option Plan for Non-employee Directors (incorporated by reference to the Form S-1).  |
| 10.4+* | Employment Agreement dated as of June 25, 1997 between PIA and Terry R.   |

Peets (incorporated by reference to Exhibit 10.5 to the Company's Form 10-Q for the 2nd Quarter ended June 30, 1997)

10.5+\* Severance Agreement dated as of February 20, 1998 between PIA and Cathy L. Wood (incorporated by reference to Exhibit 10.5 to the Company's Form 10-Q for the 1st Quarter ended April 30, 1998)

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EXHIBIT  
NUMBER  
- - - - -

DESCRIPTION  
- - - - -

10.6\* Severance Agreement dated as of August 10, 1998 between PIA and Clinton E. Owens (incorporated by reference to Exhibit 10.6 to the Company's Form 10-Q for the 3rd Quarter ended October 2, 1998).

10.7+\* Amendment No. 1 to Employment Agreement dated as of October 1, 1998 between PIA and Terry R. Peets.

10.8+\* Amended and Restated Severance Compensation Agreement dated as of October 1, 1998 between PIA and Cathy L. Wood.

10.9+ Loan and Security Agreement dated December 7, 1998 among Mellon Bank, N.A., PIA Merchandising Co., Inc., Pacific Indoor Display Co. and PIA.

10.10+ Agreement and Plan of Merger dated as of February 28, 1999 among PIA, S.G. Acquisition, Inc., PIA Merchandising Co., Inc., SPAR Acquisition, Inc., SPAR Marketing, Inc., SPAR Marketing Force, Inc., SPAR, Inc., SPAR/Burgoyne Retail Services, Inc., SPAR Incentive Marketing, Inc., SPAR MCI Performance Group, Inc. and SPAR Trademarks, Inc. (the "Agreement and Plan of Merger").

10.11+ Voting Agreement dated as of February 28, 1999 among PIA, Clinton E. Owens, RVM/PIA, California limited partnership, Robert G. Brown and William H. Bartels (the "Voting Agreement").

10.12\* Amendment No. 2 to Employment Agreement dated as of February 11, 1999 between PIA and Terry R. Peets (incorporated by reference to Exhibit 10.12 to the Company's Form 10-Q for the 2nd Quarter ended April 2, 1999).

10.13++ First Amendment to Agreement and Plan of Merger dated as of May 14, 1999.

10.14++ First Amendment to Voting Agreement dated as of May 14, 1999.

21.1 Subsidiaries of the Company (incorporated by reference to the Form S-1).

23.1++ Consent of Deloitte & Touche LLP.

27.1+ Financial Data Schedule.

+ Previously filed with initial Form 10-K for the fiscal year ended January 1, 1999.

++ Filed herewith.

\* Management contract or compensatory plan or arrangement required to be

filed as an exhibit pursuant to applicable rules of the Securities and Exchange Commission.

(b) REPORTS ON FORM 8-K.

None

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this amendment to the report to be signed on its behalf by the undersigned, thereunto duly authorized.

PIA MERCHANDISING SERVICES, INC.

By: /s/ Terry R. Peets

-----  
Terry R. Peets  
President, Chief Executive Officer and Director

Date: May 24, 1999  
-----

Pursuant to the requirements of the Securities Exchange Act of 1934, this amendment to the report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated.

| SIGNATURE<br>-----  | TITLE<br>-----  | DATE<br>----- |
|---|---|---------------|
| /s/ Clinton E. Owens<br>-----<br>Clinton E. Owens         | Chairman of the Board   | May 24, 1999  |
| /s/ Terry R. Peets<br>-----<br>Terry R. Peets             | President, Chief Executive<br>Officer and Director  | May 24, 1999  |
| /s/ Cathy L. Wood<br>-----<br>Cathy L. Wood               | Executive Vice President,<br>Chief Financial Officer and<br>Secretary (Principal Financial<br>and Accounting Officer) | May 24, 1999  |
| /s/ Patrick C. Haden<br>-----<br>Patrick C. Haden         | Director  | May 24, 1999  |
| /s/ J. Christopher Lewis<br>-----<br>J. Christopher Lewis | Director  | May 24, 1999  |
| /s/ John A. Colwell<br>-----<br>John A. Colwell           | Director  | May 24, 1999  |
| /s/ Joseph H. Coulombe<br>-----<br>Joseph H. Coulombe     | Director  | May 24, 1999  |

-----  
Patrick W. Collins

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

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| Consolidated statements of operations for each of the three years<br>in the period ended January 1, 1999           | F-4  |
| Consolidated statements of stockholders' equity for each<br>of the three years in the period ended January 1, 1999 | F-5  |
| Consolidated statements of cash flows for each of the three years<br>in the period ended January 1, 1999           | F-6  |
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| Schedule II - Valuation and qualifying accounts  | F-25 |

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of  
PIA Merchandising Services, Inc.:

We have audited the accompanying consolidated balance sheets of PIA Merchandising Services, Inc. and subsidiaries (the Company) as of December 31, 1997 and January 1, 1999, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended January 1, 1999. Our audits also included the financial statement schedule listed in Item 14(a) 2. These consolidated financial statements and financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain



reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of PIA Merchandising Services, Inc. and subsidiaries as of December 31, 1997 and January 1, 1999, and the results of their operations and their cash flows for each of the three years in the period ended January 1, 1999 in conformity with generally accepted accounting principles. Also, in our opinion, such financial statement schedule, when considered in relation to the financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

Deloitte & Touche LLP

Costa Mesa, California  
February 18, 1999

(Except for Note 14, as to which the date is February 28, 1999)

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE DATA)

ASSETS

|   | DECEMBER 31,<br>1997 | JANUARY 1,<br>1999 |
|---|----------------------|--------------------|
|   | -----                | -----              |
| CURRENT ASSETS:                           |                      |                    |
| Cash and cash equivalents                 | \$ 12,987            | \$ 11,064          |
| Accounts receivable, net (Note 3)         | 16,053               | 11,222             |
| Income tax refund receivable (Note 6)     | 2,905                | 81                 |
| Prepaid expenses and other current assets | 816                  | 712                |
|   | -----                | -----              |
| Total current assets                      | 32,761               | 23,079             |
| PROPERTY AND EQUIPMENT, net (Note 3)      | 2,416                | 1,991              |
| INVESTMENTS AND OTHER ASSETS:             |                      |                    |
| Investment in affiliate (Note 4)          | 418                  | 553                |
| Other assets                              | 872                  | 431                |
|   | -----                | -----              |
| Total investments and other assets        | 1,290                | 984                |
|   | -----                | -----              |
| Total assets                              | \$ 36,467            | \$ 26,054          |
|   | =====                | =====              |

See notes to consolidated financial statements

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (CONTINUED)  
(IN THOUSANDS, EXCEPT SHARE DATA)

LIABILITIES AND STOCKHOLDERS' EQUITY

|   | DECEMBER 31,<br>1997 | JANUARY 1,<br>1999 |
|---|----------------------|--------------------|
|   | -----                | -----              |
| CURRENT LIABILITIES:  |                      |                    |
| Accounts payable  | \$ 3,442             | \$ 1,194           |
| Other current liabilities (Note 3)  | 13,334               | 7,951              |
| Income taxes payable (Note 6)   | 47                   | 90                 |
|   | -----                | -----              |
| Total current liabilities   | 16,823               | 9,235              |
| LINE OF CREDIT AND LONG-TERM LIABILITIES (Note 5)   | 966                  | 2,095              |
| COMMITMENTS AND CONTINGENCIES (Note 8)  |                      |                    |
| STOCKHOLDERS' EQUITY (Notes 10 and 11):   |                      |                    |
| Preferred stock, \$.01 par value;<br>3,000,000 shares authorized; none issued and<br>outstanding Common stock, \$.01 par value;<br>15,000,000 shares authorized; 5,392,558 and<br>5,477,846 shares issued and<br>outstanding as of December 31, 1997<br>and January 1, 1999, respectively | 59                   | 60                 |
| Additional paid-in capital  | 33,429               | 33,740             |
| Accumulated deficit   | (11,806)             | (16,072)           |
| Less treasury stock at cost (507,000 shares at<br>December 31, 1997 and January 1, 1999)  | (3,004)              | (3,004)            |
|   | -----                | -----              |
| Total stockholders' equity  | 18,678               | 14,724             |
|   | -----                | -----              |
| Total liabilities and stockholders' equity  | \$ 36,467            | \$ 26,054          |
|   | =====                | =====              |

See notes to consolidated financial statements

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS  
(IN THOUSANDS, EXCEPT PER SHARE DATA)

|  | YEARS ENDED          |                      |                    |
|--|----------------------|----------------------|--------------------|
|  | DECEMBER 31,<br>1996 | DECEMBER 31,<br>1997 | JANUARY 1,<br>1999 |
|  | -----                | -----                | -----              |
| NET REVENUES (Note 13)                                 | \$ 119,940           | \$ 128,208           | \$ 121,788         |
| OPERATING EXPENSES:                                    |                      |                      |                    |
| Field service costs                                    | 94,841               | 119,830              | 105,448            |
| Selling expenses                                       | 11,133               | 10,482               | 8,245              |
| General and administrative expenses (Notes 7, 8 and 9) | 8,081                | 10,234               | 11,788             |
| Restructuring and other charges (Note 2)               |                      | 5,420                |                    |

|  |          |             |            |
|--|----------|-------------|------------|
| Depreciation and amortization                                | 595      | 997         | 1,129      |
|  | -----    | -----       | -----      |
| Total operating expenses                                     | 114,650  | 146,963     | 126,610    |
|  | -----    | -----       | -----      |
| OPERATING INCOME (LOSS)                                      | 5,290    | (18,755)    | (4,822)    |
| OTHER INCOME:  |          |             |            |
| Interest expense   | (46)     |             | (25)       |
| Interest income  | 869      | 799         | 487        |
| Equity in earnings of affiliate (Note 4)                     | 72       | 96          | 149        |
|  | -----    | -----       | -----      |
| Total other income   | 895      | 895         | 611        |
|  | -----    | -----       | -----      |
| INCOME (LOSS) BEFORE PROVISION (BENEFIT)<br>FOR INCOME TAXES | 6,185    | (17,860)    | (4,211)    |
| INCOME TAX PROVISION (BENEFIT) (Note 6)                      | 2,426    | (2,761)     | 55         |
|  | -----    | -----       | -----      |
| NET INCOME (LOSS)  | \$ 3,759 | \$ (15,099) | \$ (4,266) |
|  | =====    | =====       | =====      |
| BASIC EARNINGS (LOSS) PER SHARE (Note 12)                    | \$ 0.70  | \$ (2.72)   | \$ (0.78)  |
|  | =====    | =====       | =====      |
| DILUTED EARNINGS (LOSS) PER SHARE (Note 12)                  | \$ 0.63  | \$ (2.72)   | \$ (0.78)  |
|  | =====    | =====       | =====      |
| WEIGHTED AVERAGE COMMON SHARES - BASIC                       | 5,370    | 5,551       | 5,439      |
|  | =====    | =====       | =====      |
| WEIGHTED AVERAGE COMMON SHARES - DILUTED                     | 5,990    | 5,551       | 5,439      |
|  | =====    | =====       | =====      |

See notes to consolidated financial statements

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(IN THOUSANDS)

Years ended December 31, 1996 and 1997 and January 1, 1999

|  | COMMON STOCK |          | TREASURY STOCK |            | ADDITIONAL<br>PAID-IN<br>CAPITAL | RETAINED<br>EARNINGS<br>(ACCUMULATED<br>DEFICIT) | TOTAL<br>STOCKHOLDERS'<br>EQUITY |
|--|--------------|----------|----------------|------------|----------------------------------|--|----------------------------------|
|  | SHARES       | AMOUNT   | SHARES         | AMOUNT     |                                  |  |                                  |
| BALANCE, January 1, 1996                                     | 3,564        | \$ 6,454 | --             | \$ --      | \$ --                            | \$ (466)   | \$ 5,988                         |
| Change in stated par value of<br>shares from no par to \$.01 |              | (6,418)  |                |            | 6,418                            |  |                                  |
| Stock issued to the public                                   | 2,138        | 21       |                |            | 26,499                           |  | 26,520                           |
| Stock options exercised                                      | 58           | 1        |                |            | 334                              |  | 335                              |
| Tax benefit related to exercise of stock<br>options          |              |          |                |            | 116                              |  | 116                              |
| Cashless exercise of warrants (Note 11)                      | 131          |          |                |            |                                  |  |                                  |
| Net income   |              |          |                |            |                                  | 3,759  | 3,759                            |
|  | -----        | -----    | -----          | -----      | -----                            | -----  | -----                            |
| BALANCE, December 31, 1996                                   | 5,891        | 58       |                |            | 33,367                           | 3,293  | 36,718                           |
| Stock options exercised                                      | 9            | 1        |                |            | 62                               |  | 63                               |
| Repurchase of common stock                                   | (507)        |          | 507            | (3,004)    |                                  |  | (3,004)                          |
| Net loss   |              |          |                |            |                                  | (15,099)   | (15,099)                         |
|  | -----        | -----    | -----          | -----      | -----                            | -----  | -----                            |
| BALANCE, December 31, 1997                                   | 5,393        | 59       | 507            | (3,004)    | 33,429                           | (11,806)   | 18,678                           |
| Stock options exercised                                      | 30           |          |                |            | 88                               |  | 88                               |
| Employee stock purchases                                     | 12           |          |                |            | 45                               |  | 45                               |
| Shares issued as bonus (Note 10)                             | 43           | 1        |                |            | 178                              |  | 179                              |
| Net loss   |              |          |                |            |                                  | (4,266)  | (4,266)                          |
|  | -----        | -----    | -----          | -----      | -----                            | -----  | -----                            |
| BALANCE, January 1, 1999                                     | 5,478        | \$ 60    | 507            | \$ (3,004) | \$ 33,740                        | \$ (16,072)                                      | \$ 14,724                        |

See notes to consolidated financial statements

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)

|  | YEARS ENDED          |                      |                    |
|--|----------------------|----------------------|--------------------|
|  | DECEMBER 31,<br>1996 | DECEMBER 31,<br>1997 | JANUARY 1,<br>1999 |
| CASH FLOWS FROM OPERATING ACTIVITIES:  |                      |                      |                    |
| Net income (loss)  | \$ 3,759             | \$ (15,099)          | \$ (4,266)         |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: |                      |                      |                    |
| Depreciation and amortization  | 595                  | 997                  | 1,129              |
| Equity in earnings of affiliate  | (72)                 | (96)                 | (149)              |
| Deferred income taxes, net   | (167)                | 360                  |                    |
| Provision for doubtful receivables and other, net                                    | 105                  | 918                  | (270)              |
| Restructuring and other charges (Note 2)   |                      | 5,420                |                    |
| Changes in assets and liabilities:   |                      |                      |                    |
| Accounts receivable  | (10,522)             | 5,659                | 5,101              |
| Income tax refund receivable   |                      | (2,905)              | 2,824              |
| Prepaid expenses and other current assets  | 74                   | (252)                | 104                |
| Other assets   | 213                  | (744)                | 441                |
| Accounts payable   | (1,066)              | 2,670                | (2,248)            |
| Other current liabilities  | 5,657                | 173                  | (5,204)            |
| Income taxes payable   | (228)                | (64)                 | 43                 |
| Other liabilities  |                      | 131                  | (871)              |
| Net cash used in operating activities  | (1,652)              | (2,832)              | (3,366)            |
| CASH FLOWS FROM INVESTING ACTIVITIES:  |                      |                      |                    |
| Purchases of property and equipment  | (332)                | (759)                | (516)              |
| Capitalization of software development costs   | (1,987)              |                      | (174)              |
| Investment in affiliate  | (150)                |                      |                    |
| Net cash used in investing activities  | (2,469)              | (759)                | (690)              |

See notes to consolidated financial statements

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)  
(IN THOUSANDS)

YEARS ENDED

|  | DECEMBER 31,<br>1996 | DECEMBER 31,<br>1997 | JANUARY 1,<br>1999 |
|--|----------------------|----------------------|--------------------|
|  | -----                | -----                | -----              |
| CASH FLOWS FROM FINANCING ACTIVITIES:  |                      |                      |                    |
| Principal payments on long-term debt   | \$ (3,400)           | \$ --                | \$ --              |
| Proceeds from long-term debt   |                      |                      | 2,000              |
| Proceeds from issuance of common stock to the public   | 26,520               |                      |                    |
| Proceeds from issuance of common stock   | 335                  | 63                   | 133                |
| Repurchase of common stock   |                      | (3,004)              |                    |
|  | -----                | -----                | -----              |
| Net cash provided by(used in) financing activities   | 23,455               | (2,941)              | 2,133              |
|  | -----                | -----                | -----              |
| NET INCREASE (DECREASE) IN CASH AND<br>CASH EQUIVALENTS  | 19,334               | (6,532)              | (1,923)            |
| CASH AND CASH EQUIVALENTS, beginning of period   | 185                  | 19,519               | 12,987             |
|  | -----                | -----                | -----              |
| CASH AND CASH EQUIVALENTS, end of period   | \$ 19,519            | \$ 12,987            | \$ 11,064          |
|  | =====                | =====                | =====              |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW<br>INFORMATION - Cash paid (refunded) during the year for: |                      |                      |                    |
| Interest   | \$ 69                | \$ --                | \$ 25              |
|  | =====                | =====                | =====              |
| Income taxes   | \$ 2,853             | \$ 129               | \$ (2,753)         |
|  | =====                | =====                | =====              |

See Notes 10 and 11 to consolidated financial statements for description of noncash transactions.

See notes to consolidated financial statements

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR EACH OF THE THREE YEARS  
IN THE PERIOD ENDED JANUARY 1, 1999

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company Description - PIA Merchandising Services, Inc. and subsidiaries ("Company") provides in-store merchandising services primarily on behalf of branded product manufacturers at retail grocery stores, mass merchandisers, drug stores and discount drug stores. The Company's in-store services include checking for authorized distribution of client products, cutting in products approved for distribution but not present on the shelf, setting category shelves in accordance with approved store schematics, ensuring shelf tags are in place, checking for the overall salability of clients' products, and performing new product and promotion selling. The Company also performs special in-store projects, such as new store sets and existing store resets, remerchandisings, remodels and category implementations, and executes and maintains point of purchase displays and materials. In addition, the Company collects and provides to certain clients a variety of merchandising data that is category and store-specific. The Company is also a supplier of regularly scheduled, shared merchandising services in the United States. The Company's management has evaluated the allocation of resources in assessing performance and determined the Company operates in three operating segments, dedicated services, shared services, and project services (Note 13).

Principles of Consolidation - The consolidated financial statements include the accounts of PIA Merchandising Services, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The equity method of accounting is used for the Company's investment in affiliate (Note 4).

Cash Equivalents - The Company considers all highly liquid short-term investments with original maturities of three months or less to be cash equivalents.

Accounts Receivable and Credit Risk - During the ordinary course of the Company's business, the Company grants trade credit to its clients, which consist primarily of packaged goods manufacturers and retailers. The Company's ten largest clients generated approximately 57.0%, 69.0% and 75.0% of the Company's net revenues for the fiscal years ended December 31, 1996, December 31, 1997 and January 1, 1999, respectively.

During the fiscal year ended January 1, 1999, three of the Company's clients accounted for 15.6%, 12.6% and 10.6% of the Company's net revenues. During 1997, two clients accounted for 16.0% and 13.6% of the Company's net revenues. Given the significant amount of net revenues derived from certain clients, collectibility issues arising from financial difficulties of any of these clients or the loss of any such clients could have a material adverse effect on the Company's business. Unbilled accounts receivable represent merchandising services performed that are pending billing until the requisite documents have been processed or projects have been completed (Note 3).

Property and Equipment - Property and equipment are stated at cost and depreciated on the straight-line method over estimated useful lives, ranging from three to seven years. Leasehold improvements are amortized over the estimated useful life of the asset or the term of the lease, whichever is shorter.

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR EACH OF THE THREE YEARS  
IN THE PERIOD ENDED JANUARY 1, 1999

The Company has chosen to early adopt Statement of Position ("SOP") No. 98 -1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use as of January 1, 1998. The SOP provides guidance in accounting for the costs of computer software developed or obtained for internal use. The effects of the adoption of the SOP have been reflected in the 1998 consolidated financial statements and are not material.

Other Assets - Other assets consist primarily of refundable deposits.

Deferred Revenue - Client payments received in advance of merchandising services performed are classified as deferred revenue (Note 3).

Amounts Held on Behalf of Third Parties - Amounts held on behalf of third parties arise from agreements with retailers to provide services for their private label manufacturers' products and represent amounts to be utilized for certain future services including merchandising-related expenditures on behalf of the retailers (Note 3). These agreements renew annually and are cancelable on December 31 of each year or upon ninety-day written notice by either party.

Revenue Recognition - The Company's services are provided under various types of contracts, which consist primarily of fixed fee and commission-based arrangements. Under fixed fee arrangements, revenues are recognized monthly based on a fixed fee per month over a service period of typically one year, as defined in the contract.

The Company's commission-based contracts provide for commissions to be earned based on a specified percentage of the client's net sales of certain products to designated retail chains. In conjunction with these commission arrangements, the Company receives draws on a monthly basis, which are to be applied against commissions earned. These draws approximate estimated minimum revenue to be earned on the contract and are recognized on a monthly basis, over a service period of typically

one-year. The Company recognizes adjustments on commission-based sales in the period such amounts become determinable. Commissions are usually owed to the Company in excess of draws received.

The Company also performs services on a specific project basis. Revenues related to these projects are recognized as services are performed or costs are incurred. Certain of the Company's contracts are to perform project work over a specified period ranging from one to twelve months. Revenue under these types of contracts is recognized essentially on the percentage of completion method. Provisions for estimated losses on uncompleted contracts are recorded in the period in which such losses are determinable.

Field Service Costs - Field service costs are comprised principally of field labor and related costs and expenses required to provide shared services, project activities, key account management and related technology costs, as well as field overhead required to support the activities of these groups of employees.

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR EACH OF THE THREE YEARS  
IN THE PERIOD ENDED JANUARY 1, 1999

Accounting for Stock-Based Compensation - Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, requires disclosure of fair value method of accounting for stock options and other equity instruments. Under the fair value method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period, which is usually the vesting period. The Company has chosen, under the provisions of SFAS No. 123, to continue to account for employee stock-based transactions under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. The Company has disclosed in Note 11 to the consolidated financial statements pro forma diluted net income (loss) and net income (loss) per share as if the Company had applied the fair value method of accounting.

Income Taxes - Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of assets and liabilities for financial and tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred taxes are also recognized for operating losses that are available to offset future taxable income and tax credits that are available to offset future income taxes. In the event the future consequences of differences between financial reporting bases and tax bases of the Company's assets and liabilities result in deferred tax assets, an evaluation of the probability of being able to realize the future benefits indicated by such asset is required. A valuation allowance is provided when it is more likely than not that some portion or the entire deferred tax asset will not be realized.

Comprehensive Income - The Company has adopted SFAS No. 130, Reporting Comprehensive Income. For the years ended January 1, 1999, December 31, 1997 and December 31, 1996, the Company has no reported differences between net income (loss) and comprehensive income (loss). Therefore, statements of comprehensive income (loss) have not been presented.

Earnings Per Share - The Company has adopted SFAS No. 128, Earnings per Share, which replaces the presentation of "Primary" earnings per share with "Basic" earnings per share and the presentation of "Fully Diluted" earnings per share with "Diluted" earnings per share. Prior periods have been restated to reflect the change in presentation.

Basic earnings per share amounts are based upon the weighted-average number of common shares outstanding. Diluted earnings per share amounts are based upon the weighted-average number of common and potential common shares for each period presented. Potential common shares include stock options, using the treasury stock method.

Vendor Concentration - In addition to the Company's own employees, the Company utilizes a force of trained merchandisers employed by a third-party payrolling company engaged principally in the performance of retailer-mandated and project activities. For the fiscal years ended December 31, 1996, December 31, 1997 and January 1, 1999, the Company paid this payrolling company approximately \$31,145,000, \$38,936,000 and \$32,213,000, respectively (Note 3).

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR EACH OF THE THREE YEARS  
IN THE PERIOD ENDED JANUARY 1, 1999

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Fair Value of Financial Instruments - The Company's consolidated balance sheets include the following financial instruments: cash and cash equivalents, accounts receivable, accounts payable and long term debt. The Company considers carrying amounts of current assets and liabilities in the consolidated financial statements to approximate the fair value for these financial instruments, because of the relatively short period of time between origination of the instruments and their expected realization. The carrying amounts of long-term debt approximate fair value because the obligation bears interest at a floating rate.

Change in Fiscal Year - Effective January 1, 1998, the Company changed its fiscal year end for financial statement purposes from a calendar year to a 52/53-week fiscal year. Beginning with fiscal year 1998, the Company's fiscal year will end on the Friday closest to December 31. The years ended December 31, 1997 and January 1, 1999 each consist of approximately 52 weeks. The Company does not believe that this change has a material impact on the financial statements.

New Accounting Pronouncements - The Company has adopted SFAS No. 131. Disclosure About Segments of an Enterprise and Related Information. In accordance with SFAS No. 131, the Company has disclosed in Note 13 certain information about the Company's products and major customers.

In June 1998, the Financial Accounting Standards Board (the "FASB") issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, which the Company is required to adopt effective in its fiscal year 2000. SFAS No. 133 will require the Company to record all derivatives on the balance sheet at fair value. The Company does not currently engage in hedging activities and will continue to evaluate the effect of adopting SFAS No. 133. The Company is expected to adopt SFAS No. 133 in its fiscal year 2000.

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS



FOR EACH OF THE THREE YEARS  
IN THE PERIOD ENDED JANUARY 1, 1999

2. RESTRUCTURING AND OTHER CHARGES

During 1997, the Company experienced declining gross margins and resultant operating losses, due to service performance issues and the loss of several shared clients. This decline in margins has resulted in insufficient margin dollars to cover the overhead structure, which had developed at the field level and in the general corporate area. In the quarter ended September 30, 1997, the Company addressed these conditions by restructuring its operations, focusing on a more disciplined and functional operational structure, and redirecting its technology strategies, resulting in a \$5,420,000 charge for restructuring and other charges. The restructuring charges consist of \$1,522,000 identified severance of corporate and field employees and lease costs in various management and administrative functions. The restructuring charges also include \$2,121,000 in the write downs and accruals associated with the abandonment of certain internally developed software and specialized computer equipment under long-term operating leases due to a redirection of the Company's technology strategies (Note 3). Other charges consisted primarily of \$1,297,000 of reserves and write offs related to unprofitable contracts, and \$480,000 of costs associated with changes in the Company's service delivery model. At January 1, 1999, \$428,000 is remaining in accrued liabilities in the accompanying consolidated balance sheet consisting of \$410,000 to specialized computer equipment under long-term operating leases no longer in use and \$18,000 to employee separation costs.

The following table displays a rollforward of the liabilities for restructuring and other charges from December 31, 1996 to January 1, 1999 (in thousands):

| TYPE OF COST   | INITIAL<br>RESTRUCTURING<br>AND OTHER CHARGES | 1997<br>DEDUCTIONS | DECEMBER 31,<br>1997<br>BALANCE | 1998<br>DEDUCTIONS | JANUARY 1,<br>1999<br>BALANCE |
|--|---|--------------------|---------------------------------|--------------------|-------------------------------|
| Employee Separation                                  | \$ 1,372                                      | \$ (885)           | \$ 487                          | \$ (469)           | \$ 18                         |
| Facility Closing                                     | 150   |                    | 150                             | (150)              |                               |
| Technology writedown<br>and related operating leases | 2,121   | (1,086)            | 1,035                           | (625)              | 410                           |
| Unprofitable Contracts                               | 1,297   | (797)              | 500                             | (500)              |                               |
| Other  | 480   | (338)              | 142                             | (142)              |                               |
|  | -----   | -----              | -----                           | -----              | -----                         |
|  | \$ 5,420                                      | \$(3,106)          | \$ 2,314                        | \$(1,886)          | \$ 428                        |
|  | =====   | =====              | =====                           | =====              | =====                         |

Management believes that the remaining reserves for restructuring are adequate to complete its plan.

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR EACH OF THE THREE YEARS  
IN THE PERIOD ENDED JANUARY 1, 1999

3. SUPPLEMENTAL BALANCE SHEET INFORMATION

Accounts receivable, net, consist of the following (in thousands):

|           | DECEMBER 31,<br>1997 | JANUARY 1,<br>1999 |
|-----------|----------------------|--------------------|
|           | -----                | -----              |
| Trade     | \$ 15,411            | \$ 9,511           |
| Unbilled  | 2,034                | 2,358              |
| Non-trade | 59                   | 174                |

|   |           |           |
|---|-----------|-----------|
|   | -----     | -----     |
|   | 17,504    | 12,043    |
| Allowance for doubtful accounts and other | (1,451)   | (821)     |
|   | -----     | -----     |
|   | \$ 16,053 | \$ 11,222 |
|   | =====     | =====     |

Property and equipment, net, consist of the following (in thousands):

|  |              |            |
|--|--------------|------------|
|  | DECEMBER 31, | JANUARY 1, |
|  | 1997         | 1999       |
|  | -----        | -----      |
| Equipment                                      | \$ 3,680     | \$ 3,873   |
| Furniture and fixtures                         | 662          | 719        |
| Leasehold improvements                         | 160          | 165        |
| Capitalized software development costs         | 902          | 1,076      |
|  | -----        | -----      |
|  | 5,404        | 5,833      |
| Less accumulated depreciation and amortization | (2,988)      | (3,842)    |
|  | -----        | -----      |
|  | \$ 2,416     | \$ 1,991   |
|  | =====        | =====      |

During 1997, the Company recorded certain restructuring charges (Note 2). In connection with the restructuring, the Company recorded a charge of approximately \$1,000,000 for the impairment of capitalized software costs.

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Other current liabilities consist of the following (in thousands):

|  |              |            |
|--|--------------|------------|
|  | DECEMBER 31, | JANUARY 1, |
|  | 1997         | 1999       |
|  | -----        | -----      |
| Accrued salaries and other related costs   | \$ 1,237     | \$ 1,123   |
| Accrued payroll to third party             | 2,847        | 1,557      |
| Accrued medical and compensation insurance | 1,456        | 1,906      |
| Deferred revenue                           | 1,039        | 426        |
| Amounts held on behalf of third parties    | 1,116        | 641        |
| Accrued rebate                             | 2,200        |            |
| Restructuring costs                        | 1,475        | 428        |
| Other                                      | 1,964        | 1,870      |
|  | -----        | -----      |
|  | \$13,334     | \$ 7,951   |
|  | =====        | =====      |

4. INVESTMENT IN AFFILIATE

During 1996, the Company increased its voting ownership in Ameritel Corporation, a full-service telemarketing company, to 20%. Accordingly,

the Company changed its method of carrying the investment from cost to equity as required by generally accepted accounting principles. The change in method was not material to the carrying value of the investment in the accompanying financial statements.

Following is a summary of condensed unaudited financial information pertaining to Ameritel Corporation (in thousands):

|                         | DECEMBER 31,<br>1997 | JANUARY 1,<br>1999 |
|-------------------------|----------------------|--------------------|
|                         | -----                | -----              |
| Current assets          | \$1,545              | \$2,816            |
| Noncurrent assets       | 1,252                | 3,786              |
| Current liabilities     | 1,443                | 1,827              |
| Long-term liabilities   | 128                  | 2,803              |
| Stockholders' equity    | 1,226                | 1,972              |
| Net income for the year | 523                  | 746                |

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5. LINE OF CREDIT

On December 10, 1998, the Company entered a long-term revolving line of credit agreement a bank to provide an asset-based credit facility with maximum borrowing up to \$20.0 million. Under this agreement, the line is to expire on December 7, 2001. All revolving credit loans bear interest at the agent bank's prime rate plus 0.25 % (7.75% at January 1, 1999, or 8.0%), or the London Interbank Offered Rate ("LIBOR") plus 2.75% (5.06% at January 1, 1999, or 7.81%) at the Company's option. As of January 1, 1999, the outstanding balance on the line of credit was \$2,000,000. The Company's available borrowing is the sum of 80% of all eligible accounts receivable, plus 100% of eligible cash collateral less outstanding revolving credit loan.

Under the terms of the long-term debt agreement, the Company is subject to certain financial covenants. Key covenants require the Company to maintain a minimum current ratio, total liabilities to tangible net worth ratio, tangible net worth, working capital, and net income. At January 1, 1999, the Company complied with all such covenants. As of January 1, 1999, available borrowings were \$4,796,000.

6. INCOME TAXES

The provision (benefit) for income taxes is summarized below for the years ended December 31, 1996, December 31, 1997 and January 1, 1999 (in thousands):

|                       | YEARS ENDED          |                      |                    |
|-----------------------|----------------------|----------------------|--------------------|
|                       | DECEMBER 31,<br>1996 | DECEMBER 31,<br>1997 | JANUARY 1,<br>1999 |
|                       | -----                | -----                | -----              |
| Current income taxes: |                      |                      |                    |
| Federal               | \$ 2,163             | \$ (3,082)           | \$ --              |
| State                 | 430                  | (19)                 | 55                 |

|                                      |          |            |         |
|--------------------------------------|----------|------------|---------|
|                                      | -----    | -----      | -----   |
|                                      | 2,593    | (3,101)    | 55      |
| Deferred income taxes:               |          |            |         |
| Federal                              | (135)    | (2,846)    | (1,554) |
| State                                | (32)     | (380)      | (1)     |
|                                      | -----    | -----      | -----   |
|                                      | (167)    | (3,226)    | (1,555) |
| Increase in valuation allowance      |          | 3,566      | 1,555   |
|                                      | -----    | -----      | -----   |
| Provision (benefit) for income taxes | \$ 2,426 | \$ (2,761) | \$ 55   |
|                                      | =====    | =====      | =====   |

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Reconciliation between the provision (benefit) for income taxes as required by applying the federal statutory rate of 35% to that included in the financial statements is as follows (in thousands):

|  |              |              |            |
|--|--------------|--------------|------------|
|  | -----        |              |            |
|  | YEARS ENDED  |              |            |
|  | -----        | -----        | -----      |
|  | DECEMBER 31, | DECEMBER 31, | JANUARY 1, |
|  | 1996         | 1997         | 1999       |
|  | -----        | -----        | -----      |
| Provision (benefit) for income taxes at federal statutory rate | \$ 2,165     | \$ (6,251)   | \$ (1,473) |
| State income taxes, net of federal benefit                     | 259          | (12)         | 14         |
| Other permanent differences                                    | (31)         |              |            |
| Change in valuation allowance                                  |              | 3,566        | 1,555      |
| Other  | 33           | (64)         | (41)       |
|  | -----        | -----        | -----      |
| Provision (benefit) for income taxes                           | \$ 2,426     | \$ (2,761)   | \$ 55      |
|  | =====        | =====        | =====      |

Deferred taxes consist of the following (in thousands):

|  |              |            |
|--|--------------|------------|
|  | DECEMBER 31, | JANUARY 1, |
|  | 1997         | 1999       |
|  | -----        | -----      |
| Net operating loss carryforwards                     | \$ 1,877     | \$ 3,880   |
| State tax provision                                  | (270)        | (146)      |
| Accrued compensation                                 | 131          | 229        |
| Accrued insurance                                    | 427          | 793        |
| Allowance for doubtful accounts and other receivable | 1,158        | 312        |
| Depreciation   | (180)        | (52)       |
| Other  | 423          | 105        |
|  | -----        | -----      |
| Deferred tax assets                                  | 3,566        | 5,121      |
| Valuation allowance                                  | (3,566)      | (5,121)    |
|  | -----        | -----      |
| Net deferred taxes                                   | \$ --        | \$ --      |

At January 1, 1999, the Company has net operating loss carry forwards of \$10,688,000 available to reduce future federal taxable income and \$3,815,000 available to reduce future California State taxable income. The Company has Federal and California net operating loss carry forwards which begin expiring in the year 2012 and 2002, respectively. The Company has established a full valuation allowance for the deferred tax assets due to its continuing losses.

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7. EMPLOYEE BENEFITS

Pension Plans - Certain of the Company's employees are covered by union-sponsored, collectively bargained, multi-employer pension plans. Pension expense related to these plans was approximately \$172,000, \$178,000 and \$202,000 for the years ended December 31, 1996, December 31, 1997 and January 1, 1999, respectively. The administrators have advised the Company that there were no withdrawal liabilities as of December 1990, the most recent date for which an analysis was made. The Company has no current intention of withdrawing from any of these plans.

Retirement Plan - The Company has a 401(k)-retirement plan covering all employees not participating in the pension plans. Eligible employees, as defined by the 401(k) plan, may elect to contribute up to 15% of their total compensation; not to exceed the amount allowed by the Internal Revenue Service code guidelines. The Company makes matching contributions to the 401(k) plan each year equal to 50% of the employee contributions, not to exceed 4% of the total compensation, and can also make discretionary matching contributions. Employee contributions are fully vested at all times, and the Company's matching contributions vest over five years. The Company's matching contributions were approximately \$468,000, \$506,000 and \$471,000 for the years ended December 31, 1996, December 31, 1997 and January 1, 1999, respectively.

8. COMMITMENTS AND CONTINGENCIES

The Company leases its facilities under operating leases and leases certain computer and office equipment under two- to five-year operating lease agreements. Total rent expense relating to these leases was approximately \$2,756,000, \$6,369,000 and \$5,646,000 for the years ended December 31, 1996, December 31, 1997 and January 1, 1999, respectively, with sublease income of \$101,000 in fiscal year 1998.

The following table sets forth future minimum lease payments under noncancelable operating leases as of January 1, 1999 (in thousands):

| Fiscal Year:                        | Rent    | Sublease | Total   |
|-------------------------------------|---------|----------|---------|
|                                     | -----   | -----    | -----   |
| 1999                                | \$4,038 | \$ (261) | \$3,777 |
| 2000                                | 1,882   |          | 1,882   |
| 2001                                | 1,238   |          | 1,238   |
| 2002                                | 903     |          | 903     |
| 2003                                | 147     |          | 147     |
|                                     | -----   | -----    | -----   |
| Total future minimum lease payments | \$8,208 | \$ (261) | \$7,947 |
|                                     | =====   | =====    | =====   |

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## 9. RELATED-PARTY TRANSACTIONS

The Company receives legal services from a law firm previously affiliated with its principal stockholder and paid approximately \$516,000, \$189,000 and \$114,000 for such legal services during the years ended December 31, 1996, December 31, 1997 and January 1, 1999, respectively.

The Company has an investment in an affiliate, which provides telemarketing and related services (Note 4). The Company paid approximately \$524,000 and \$898,000 during the years ended December 31, 1997 and January 1, 1999, respectively. Approximately \$50,000 was payable to the affiliate at January 1, 1999.

## 10. STOCK TRANSACTIONS AND WARRANTS

In March 1996, the Company completed an initial stock offering and sold 1,788,000 shares of its common stock, at a net price of \$13.02 per share. An additional 349,800 shares of common stock were sold also at a net \$13.02 per share, pursuant to an underwriters over-allotment provision. The net proceeds of the approximately \$26.5 million raised by the Company were used, in part, to repay existing bank debt.

During the three fiscal years 1996, 1997 and 1998, the Company issued the following shares of common stock, 57,798 shares, 8,107 shares, and 30,328 shares, respectively as a result of options that were exercised (Note 11). The income tax effect of any difference between the market price of the Company's common stock at the grant date and the market price at the exercise date is credited to additional paid-in capital, as required.

On February 17, 1997, the Company adopted an Employee Stock Purchase Plan ("ESP Plan"). The ESP Plan allows employees of the Company to purchase common stock at a discount, without having to pay any commissions on the purchases. The discount is the greater of 15% of the fair market value ("FMV") at the end of the reportable period or the difference between the FMV at the beginning and end of the reportable period. The maximum amount that any employee can contribute to the ESP Plan per quarter is \$6,250, and the total number of shares reserved by the Company for purchase under the ESP Plan is 200,000. During 1998, the Company issued 12,290 shares of common stock, at a weighted average price of \$3.69 per share.

In May 1998, the Company issued 42,670 shares of common stock to two employees as compensation for services and recorded \$179,000 of compensation expense.

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During February 1996, 100,000 warrants issued in conjunction with a 1992 line of credit for the purchase of 152,405 shares of common stock at \$1.82 per share, were exercised through a cashless exercise, based on the estimated fair market value of the Company's common stock, at the date of

exercise of \$14.00, reduced the number of shares issued to 87,000. During October 1996, the remaining warrants to purchase 52,405 shares of common stock at \$1.82 per share were exercised through a cashless exercise, based on the estimated fair value of the Company's common stock at the date of exercise of \$12.75, reduced the number of shares issued to 44,924.

#### 11. STOCK OPTIONS

The Company has three stock option plans: the 1990 Stock Option Plan (1990 Plan), the 1995 Stock Option Plan (1995 Plan), and the 1995 Director's Plan (Director's Plan).

The 1990 Plan is a nonqualified option plan providing for the issuance of up to 810,811 shares of common stock to officers, directors and key employees. The options have a term of 10 years and one week and are either fully vested or will vest ratably no later than five years from the grant date. During 1995, the Company elected to no longer grant options under this plan.

The 1995 Plan provides for the granting of either incentive or nonqualified stock options to specified employees, consultants and directors of the Company for the purchase of up to 1,300,000 shares of the Company's common stock. The options have a term of ten years, except in the case of incentive stock options granted to greater than ten-percent stockholders of the Company, for which the term is five years. The exercise price of nonqualified stock options must be equal to at least 85% of the fair market value of the Company's common stock at the date of grant; the exercise price of incentive stock options must be equal to at least the fair market value of the Company's common stock at the date of grant. At January 1, 1999, options to purchase 281,746 shares were available for grant under this plan.

The Director's Plan is a stock option plan for nonemployee directors and provides for the purchase of up to 100,000 shares of the Company's common stock. An option to purchase 1,500 shares of the Company's common stock shall be granted automatically each year to each director, following the Company's annual stockholders' meeting. The exercise price of options issued under this plan shall be not less than the fair market value of the Company's common stock on the date of grant. Each option under this plan shall vest and become exercisable in full on the first anniversary of its grant date, provided the optionee is reelected as a director of the Company. The maximum term of options granted under the plan is ten years and one day, subject to earlier termination following an optionee's cessation of service with the Company. At January 1, 1999, options to purchase 89,500 shares were available for grant under this plan.

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

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The Company has adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock-Based Compensation. No compensation cost has been recognized for the stock option plans. The impact of stock options granted prior to 1995 has been excluded from the pro forma calculation; accordingly, the 1996, 1997 and 1998 pro forma adjustments may not be indicative of future period pro forma adjustments, when the calculation will apply to all applicable future stock options. Had compensation cost for the Company's option plans been determined based on the fair value at the grant date for awards in 1996, 1997 and 1998 consistent with the provisions of SFAS No. 123, the Company's net income (loss) and net income (loss) per share would have been reduced to the pro forma amounts indicated below:

Years Ended

|  | DECEMBER 31,<br>1996 | DECEMBER 31,<br>1997 | JANUARY 1,<br>1999 |
|--|----------------------|----------------------|--------------------|
| Net income (loss), as reported (in thousands)    | \$ 3,759             | \$ (15,099)          | \$ (4,266)         |
| Net income (loss), pro forma (in thousands)      | \$ 3,564             | \$ (15,808)          | \$ (5,420)         |
| Basic net income (loss) per share, as reported   | \$ 0.70              | \$ (2.72)            | \$ (0.78)          |
| Basic net income (loss) per share, pro forma     | \$ 0.66              | \$ (2.85)            | \$ (1.00)          |
| Diluted net income (loss) per share, as reported | \$ 0.63              | \$ (2.72)            | \$ (0.78)          |
| Diluted net income (loss) per share, pro forma   | \$ 0.60              | \$ (2.85)            | \$ (1.00)          |

The fair value of each option grant is estimated based on the date of grant using the Black-Scholes option-pricing model, using the return on a ten year treasury bill, with the following weighted-average assumptions used for grants in 1998: dividend yield of 0%; expected volatility of 104.6%; risk-free interest rate of 4.7%; and expected lives of six years. The following weighted-average assumptions were used for grants in 1997: dividend yield of 0%; expected weighted-average volatility of 79.5%; risk-free interest rate of 6.2%; and expected lives of six years. The following assumptions were used for grants in 1996: dividend yield of 0%; expected volatility of 101.7%; risk-free interest rate of 6.3%; and expected lives of six years.

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The following table summarizes activity under the Company's 1990 Plan, 1995 Plan and Directors' Plan:

|  | YEARS ENDED            |                                 |                        |                                 |                        |                                 |
|--|------------------------|---------------------------------|------------------------|---------------------------------|------------------------|---------------------------------|
|  | DECEMBER 31,<br>1996   |                                 | DECEMBER 31,<br>1997   |                                 | JANUARY 1,<br>1999     |                                 |
|  | SHARES                 | WEIGHTED-AVERAGE EXERCISE PRICE | SHARES                 | WEIGHTED-AVERAGE EXERCISE PRICE | SHARES                 | WEIGHTED-AVERAGE EXERCISE PRICE |
| Options outstanding, beginning of year                         | 791,356                | \$ 6.76                         | 883,202                | \$ 8.12                         | 1,526,851              | \$ 6.10                         |
| Options granted  | 234,540                | \$ 13.57                        | 938,325                | \$ 5.55                         | 350,500                | \$ 5.49                         |
| Options exercised  | (57,798)               | \$ 5.85                         | (8,107)                | \$ 7.77                         | (30,328)               | \$ 2.91                         |
| Options canceled or expired                                    | (84,896)               | \$ 9.25                         | (286,569)              | \$ 10.45                        | (408,738)              | \$ 6.51                         |
| Options outstanding, end of year                               | 883,202                | \$ 8.12                         | 1,526,851              | \$ 6.10                         | 1,438,285              | \$ 5.91                         |
| Option price range at end of year                              | \$ 2.78 to<br>\$ 14.00 |                                 | \$ 2.78 to<br>\$ 14.00 |                                 | \$ 2.78 to<br>\$ 14.00 |                                 |
| Option price range for exercised shares                        | \$ 2.78 to<br>\$ 9.81  |                                 | \$ 7.40 to<br>\$ 8.51  |                                 | \$ 2.78 to<br>\$ 5.32  |                                 |
| Weighted-average fair value of options granted during the year | \$ 11.18               |                                 | \$ 4.01                |                                 | \$ 5.49                |                                 |

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## PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

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The following table summarizes information about fixed-price stock options outstanding at January 1, 1999:

| RANGE OF EXERCISE PRICES | OPTIONS OUTSTANDING                   |   |                                 | OPTIONS EXERCISABLE                   |                                 |
|--------------------------|---------------------------------------|---|---------------------------------|---------------------------------------|---------------------------------|
|                          | NUMBER OUTSTANDING AT JANUARY 1, 1999 | WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE | WEIGHTED-AVERAGE EXERCISE PRICE | NUMBER EXERCISABLE AT JANUARY 1, 1999 | WEIGHTED-AVERAGE EXERCISE PRICE |
| \$2.78                   | 129,729                               | 3.17  | \$ 2.78                         | 129,729                               | \$ 2.78                         |
| \$3.69-\$6.25            | 1,005,119                             | 8.91  | \$ 5.51                         | 208,537                               | \$ 5.55                         |
| \$7.40-\$9.81            | 263,302                               | 5.09  | \$ 7.75                         | 261,275                               | \$ 7.74                         |
| \$14.00                  | 40,135                                | 7.51  | \$ 14.00                        | 35,135                                | \$ 14.00                        |
| \$2.78 to \$14.00        | 1,438,285                             | 7.65  | \$ 5.91                         | 634,676                               | \$ 6.35                         |

Outstanding warrants are summarized below:

|                            | SHARES SUBJECT TO WARRANTS | EXERCISE PRICE PER SHARE |
|----------------------------|----------------------------|--------------------------|
| Balance, January 1, 1996   | 248,800                    | \$1.82 - \$8.51          |
| Exercised                  | (152,405)                  | \$1.82                   |
| Balance, December 31, 1996 | 96,395                     | \$2.78 - \$8.51          |
| Balance, December 31, 1997 | 96,395                     | \$2.78 - \$8.51          |
| Balance, January 1, 1999   | 96,395                     | \$2.78 - \$8.51          |

The above warrants expire at various dates from 2002 through 2004.

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## PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

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## 12. EARNINGS PER SHARE

| YEARS ENDED  |              |            |
|--------------|--------------|------------|
| DECEMBER 31, | DECEMBER 31, | JANUARY 1, |

|  | 1996                                  | 1997                 | 1999                |
|--|---------------------------------------|----------------------|---------------------|
|  | -----                                 | -----                | -----               |
|  | (in thousands, except per share data) |                      |                     |
| Basic:                                     |                                       |                      |                     |
| Weighted-average common shares outstanding | 5,370                                 | 5,551                | 5,439               |
| Net income (loss)                          | \$ 3,759<br>=====                     | \$ (15,099)<br>===== | \$ (4,266)<br>===== |
| Basic earnings per share                   | \$ 0.70<br>=====                      | \$ (2.72)<br>=====   | \$ (0.78)<br>=====  |
| Diluted:                                   |                                       |                      |                     |
| Weighted-average common shares - basic     | 5,370                                 | 5,551                | 5,439               |
| Potential common shares                    | 620<br>-----                          | <br>-----            | <br>-----           |
| Weighted-average common shares - diluted   | 5,990<br>=====                        | 5,551<br>=====       | 5,439<br>=====      |
| Net income (loss)                          | \$ 3,759<br>=====                     | \$ (15,099)<br>===== | \$ (4,266)<br>===== |
| Diluted earnings per share                 | \$ 0.63<br>=====                      | \$ (2.72)<br>=====   | \$ (0.78)<br>=====  |

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PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

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13. SUPPLEMENTAL INFORMATION

The Company's primary line of business is merchandising and sales services. The Company does not have separate segment (service line) managers or discrete financial information for its three primary lines of services. Therefore, management considers its merchandising and sales services a single operating segment. The information reported in the following table includes revenues for the Company's three primary merchandising and sales service line (in thousands):

|                  | SERVICE LINES      |                    |                    |                    |
|------------------|--------------------|--------------------|--------------------|--------------------|
|                  | -----              | -----              | -----              | -----              |
|                  | DEDICATED          | SHARED SERVICE     | PROJECTS           | TOTAL              |
|                  | -----              | -----              | -----              | -----              |
| Fiscal year 1998 |                    |                    |                    |                    |
| Net revenues     | \$ 38,766<br>===== | \$ 40,216<br>===== | \$ 42,806<br>===== | \$121,788<br>===== |
| Fiscal year 1997 |                    |                    |                    |                    |
| Net revenues     | \$ 44,423<br>===== | \$ 44,932<br>===== | \$ 38,853<br>===== | \$128,208<br>===== |
| Fiscal year 1996 |                    |                    |                    |                    |
| Net revenues     | \$ 21,894<br>===== | \$ 68,446<br>===== | \$ 29,600<br>===== | \$119,940<br>===== |

During the years ended January 1, 1999, December 31, 1997 and December 31, 1996, sales to two major customers (three major customers for year ended

January 1, 1999) totaled \$47.3 million, 38.0 million and \$26.4 million, respectively.

Dedicated services generally consist of regularly scheduled, routed merchandising services performed for a specific retailer or manufacturer by a dedicated organization. The merchandisers and management team work exclusively for that retailer or manufacturer. These services are normally provided under multi-year contracts.

Shared services consist of regularly scheduled, routed merchandising services provided at the stores for multiple manufacturers, primarily under multi-year contracts. Shared services may include activities such as ensuring that client's products authorized for distribution are in stock and on the shelf, adding in new products that are approved for distribution but not present 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 clients' products and selling new product and promotional items.

Project services consist primarily of specific in-store services initiated by retailers and manufacturers, such as new product launches, special seasonal or promotional merchandising, focused product support and product recalls. These services are used typically for large-scale implementations over 30 days. The Company also performs other project services, such as new store sets and existing store resets, re-merchandising, remodels and category implementations, under shared service contracts or stand-alone project contracts.

14. SUBSEQUENT EVENT

On February 28, 1999, the Company signed a definitive agreement with the SPAR Group to merge in a stock transaction involving the issuance of PIA stock to the shareholders of the SPAR Group. The transaction is subject to shareholder and regulatory approval. After the merger, SPAR Group shareholders will control PIA. The merger agreement currently requires the closing to occur by June 30, 1999.

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EXHIBIT 11.1

PIA MERCHANDISING SERVICES, INC. AND SUBSIDIARIES

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS  
(IN THOUSANDS)

| DESCRIPTION                               | BALANCE AT<br>BEGINNING<br>OF YEAR | ADDITIONS<br>CHARGED TO<br>COSTS AND<br>EXPENSES (1) | WRITE OFFS<br>AND<br>ALLOWANCE<br>CHARGES | BALANCE AT<br>END<br>OF YEAR |
|---|------------------------------------|--|---|------------------------------|
|   | -----                              | -----  | -----                                     | -----                        |
| Year ended December 31, 1996 -            |                                    |  |   |                              |
| Allowance for doubtful accounts and other | \$ 424                             | \$ 105   | \$ 54                                     | \$ 583                       |
| Year ended December 31, 1997 -            |                                    |  |   |                              |
| Allowance for doubtful accounts and other | \$ 583                             | \$ 918   | \$ (50)                                   | \$ 1,451                     |
| Year ended January 1, 1999 -              |                                    |  |   |                              |
| Allowance for doubtful accounts and other | \$ 1,451                           | \$ (270)   | \$ (360)                                  | \$ 821                       |

(1) Includes amounts charged to revenues for rebates, price adjustments and other.

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EXHIBIT INDEX

| EXHIBIT<br>NUMBER<br>- - - - - | DESCRIPTION<br>-----  |
|--------------------------------|---|
| 3.1                            | Certificate of Incorporation of PIA (incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 33-80429) as filed with the Securities and Exchange Commission on December 14, 1995 (the "Form S-1")   |
| 3.2                            | By-laws of PIA (incorporated by reference to the Form S-1).   |
| 4.1                            | Registration Rights Agreement entered into as of January 21, 1992 by and between RVM Holding Corporation, RVM/PIA, a California Limited Partnership, The Riordan Foundation and Creditanstalt-Bankverein (incorporated by reference to the Form S-1).   |
| 10.1                           | 1990 Stock Option Plan (incorporated by reference to the Form S-1).   |
| 10.2                           | Amended and Restated 1995 Stock Option Plan (incorporated by reference of Exhibit 10.2 to the Company's Form 10-Q for the 2nd Quarter ended July 3, 1998).  |
| 10.3                           | 1995 Stock Option Plan for Non-employee Directors (incorporated by reference to the Form S-1).  |
| 10.4+*                         | Employment Agreement dated as of June 25, 1997 between PIA and Terry R. Peets (incorporated by reference to Exhibit 10.5 to the Company's Form 10-Q for the 2nd Quarter ended June 30, 1997)  |
| 10.5+*                         | Severance Agreement dated as of February 20, 1998 between PIA and Cathy L. Wood (incorporated by reference to Exhibit 10.5 to the Company's Form 10-Q for the 1st Quarter ended April 30, 1998)   |
| 10.6*                          | Severance Agreement dated as of August 10, 1998 between PIA and Clinton E. Owens (incorporated by reference to Exhibit 10.6 to the Company's Form 10-Q for the 3rd Quarter ended October 2, 1998).  |
| 10.7+*                         | Amendment No. 1 to Employment Agreement dated as of October 1, 1998 between PIA and Terry R. Peets.   |
| 10.8+*                         | Amended and Restated Severance Compensation Agreement dated as of October 1, 1998 between PIA and Cathy L. Wood.  |
| 10.9+                          | Loan and Security Agreement dated December 7, 1998 among Mellon Bank, N.A., PIA Merchandising Co., Inc., Pacific Indoor Display Co. and PIA.  |
| 10.10+                         | Agreement and Plan of Merger dated as of February 28, 1999 among PIA, S.G. Acquisition, Inc., PIA Merchandising Co., Inc., SPAR Acquisition, Inc., SPAR Marketing, Inc., SPAR Marketing Force, Inc., SPAR, Inc., SPAR/Burgoyne Retail Services, Inc., SPAR Incentive Marketing, Inc., SPAR MCI Performance Group, Inc. and SPAR Trademarks, Inc. (the "Agreement and Plan of Merger") |
| 10.11+                         | Voting Agreement dated as of February 28, 1999 among PIA, Clinton E. Owens, RVM/PIA, California limited partnership, Robert G. Brown and William H. Bartels (the "Voting Agreement").   |
| 10.12*                         | Amendment No. 2 to Employment Agreement dated February 11, 1999 between PIA and Terry R. Peets (incorporated by reference to Exhibit 10.12 to the Company's Form 10-Q for the Quarter ended April 2, 1999).   |
| 10.13++                        | First Amendment to Agreement and Plan of Merger dated May 14, 1999.   |

- 10.14++ First Amendment to Voting Agreement dated May 14, 1999.
- 21.1 Subsidiaries of the Company (incorporated by reference to the Form S-1).
- 23.1++ Consent of Deloitte & Touche LLP.
- 27.1+ Financial Data Schedule.
  - ++ Filed herewith.
  - + Previously filed with initial Form 10-K for the fiscal year ended January 1, 1999.
  - \* Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to applicable rules of the Securities and Exchange Commission.

FIRST AMENDMENT  
TO  
AGREEMENT AND PLAN OF MERGER

THIS FIRST AMENDMENT TO AGREEMENT AND PLAN OF MERGER, dated as of May \_\_, 1999 (this "Amendment"), is by and among PIA MERCHANDISING SERVICES, INC., a Delaware corporation ("PIA Delaware"), SG ACQUISITION, INC., a Nevada corporation ("PIA Acquisition"), PIA MERCHANDISING CO., INC., a California corporation ("PIA California"), SPAR ACQUISITION, INC., a Nevada corporation ("SAI"), SPAR MARKETING, INC., a Delaware corporation ("SMI"), SPAR MARKETING FORCE, INC., a Nevada corporation ("SMF"), SPAR, INC., a Nevada corporation ("SINC"), SPAR/BURGOYNE RETAIL SERVICES, INC., an Ohio corporation ("SBRS"), SPAR MARKETING, INC., a Nevada corporation ("SMNEV"), SPAR INCENTIVE MARKETING, INC., a Delaware corporation ("SIM"), SPAR MCI PERFORMANCE GROUP, INC., a Delaware corporation ("SMCI"), and SPAR TRADEMARKS, INC., a Nevada corporation ("STM"). SMF, SINC, SMNEV and SBRS are sometimes referred to herein individually as a "SPAR Marketing Company" and collectively as the "SPAR Marketing Companies". SMI and the SPAR Marketing Companies are sometimes referred to herein individually as a "SPAR Marketing Party" and collectively as the "SPAR Marketing Parties". SIM and SMCI are sometimes referred to herein individually as a "SPAR Incentive Party" and collectively as the "SPAR Incentive Parties". SAI, STM, the SPAR Marketing Parties and the SPAR Incentive Companies are sometimes referred to herein individually as a "SPAR Party" and collectively as the "SPAR Parties". PIA Delaware, PIA Acquisition and PIA California are sometimes referred to herein individually as a "PIA Party" and collectively as the "PIA Parties". The PIA Parties and the SPAR Parties are sometimes referred to herein individually as a "Party" and collectively as the "Parties".

RECITALS

The PIA Parties and the SPAR Parties are parties to that certain Agreement and Plan of Merger dated as of February 28, 1999, which includes modifications made pursuant to the Page Substitution Amendment to Merger Agreement and Merger Documents among the Parties dated as of March \_\_, 1999 (as so modified, the "Existing Merger Agreement", and as modified by this Amendment, and as the same may be supplemented, modified, amended, restated or replaced from time to time in the manner provided therein, the "Merger Agreement"). Capitalized terms used and not otherwise defined or amended in this Amendment shall have the meanings respectively assigned to them in the Merger Agreement or other "Merger Documents" (as defined in the Merger Agreement).

The Parties have each determined that it is in its best interest to amend the Existing Merger Agreement as provided below, and have entered into this Amendment in order to do so, all upon the terms and provisions and subject to the conditions hereinafter set forth.

AGREEMENT

In consideration of the foregoing, the mutual covenants and agreements hereinafter set forth and other good and valuable consideration (the receipt and adequacy of which are hereby acknowledged by the Parties), the Parties hereto hereby agree as follows:

Section 1. Amendment to Existing Merger Agreement. The Existing Merger Agreement is hereby amended as follows, effective as of the date first written above:

(A) Recital E of the Existing Merger Agreement is hereby deleted in its entirety, and the following new Recital E is hereby inserted in its place:

E. Pursuant to the SPAR Reorganization Agreement, SAI will issue to the SPAR Principals sufficient additional shares of SAI Stock such that (after such issuance and including shares previously issued to them) they will then together own shares of SAI Stock equal in number to (i) the product of (A) two and one-third (2 1/3) times (B) the total number of shares of PIA Delaware Stock (as hereinafter defined) issued

and outstanding as of the close of business on the Business Day preceding the Closing Date (as defined in the Reorganization Agreement), minus (ii) the sum of the number of shares of SAI Stock issuable upon exercise of the SAI Options (without regard to the vesting provisions thereof) plus shares of SAI Stock owned by stockholders other than the SPAR Principals.

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(B) Recital I of the Existing Merger Agreement is hereby deleted in its entirety, and the following new Recital I is hereby inserted in its place:

I. As provided herein, (i) as a result of the Merger, each outstanding share of SAI Common Stock will be converted into the right to receive one share of common stock of PIA Delaware, par value \$0.01 per share ("PIA Delaware Stock"), and (ii) following the Merger, each SAI Option Holder will receive a Substitute Option (as hereinafter defined) to purchase the same number of shares of PIA Delaware Stock on the same terms as the number of shares of SAI Stock that such SAI Option Holder was entitled to purchase under such SAI Option. Immediately following the Merger, (A) the SPAR Stockholders will hold and the SAI Option Holders will have the right to acquire upon exercise (without regard to vesting) shares of PIA Delaware Stock that, in the aggregate, will represent approximately 70% of the sum of (1) the total number of shares of PIA Delaware Stock issued and outstanding immediately after the Merger plus (2) the total number of shares of PIA Delaware Stock issuable upon exercise of the Substitute Options (without regard to vesting), and (B) the shares of PIA Delaware Stock held by stockholders of PIA Delaware immediately prior to the Merger will represent approximately 30% of such post-Merger sum.

(C) In Section 4.03 of the Existing Merger Agreement, subsection (b) is hereby deleted in its entirety, and the following new subsection (b) is hereby inserted in its place:

(b) The Board of Directors of PIA Delaware (the "PIA Delaware Board") (i) has authorized and approved the adoption of an amendment to PIA Delaware's certificate of incorporation in the form annexed hereto as Exhibit E (together with such changes as may be made therein in accordance with the PIA Delaware Board's approval, but subject to the consent of the SPAR Parties, the "Charter Amendment"), which (among other things) provides for an increase in the authorized number of shares of PIA Delaware Stock to 47,000,000 shares, changes the name of PIA Delaware to "SPAR GROUP, INC." (or such other name as the Parties may mutually agree prior to the mailing of the PIA Proxy Materials), and deletes Article Tenth containing the prohibition against actions by stockholders without a meeting (i.e., Charter Amendment No. 1, Charter Amendment No. 2, Charter Amendment No. 3 as defined in the PIA Proxy Statement); (ii) has authorized for inclusion in the proxy statement, a proposal to authorize the PIA Delaware Board, if deemed necessary in its sole discretion (after obtaining the consent of the SPAR Parties, if such amendment is to be effected prior to the Merger or the termination of this Agreement), to amend PIA Delaware's certificate of incorporation (in the form annexed hereto as Exhibit E-1) to effect a reverse stock split of the issued and outstanding shares of PIA Delaware Stock on the basis of one of the following ratios: one new share in exchange for every two issued and outstanding shares, one new share in exchange for every three issued and outstanding shares, or one new share in exchange for every four issued and outstanding shares, with the PIA Delaware Board having the discretion to determine the appropriate ratio to use immediately prior to effecting the reverse stock split (the "Reverse Split Proposal" and together with the Charter Amendment, the "Proposed PIA Certificate of Amendment"), and (iii) has directed that the Proposed PIA Certificate of Amendment be submitted to PIA Delaware's stockholders at the PIA Stockholders Meeting (as such term is defined in Section 5.01). Upon the approval of the Proposed PIA Certificate of Amendment by the stockholders of PIA Delaware as required by the Delaware General Corporation Law (the "DGCL") and the filing thereof with the Secretary of State of the State of Delaware, the shares of PIA Delaware Stock to be issued in connection with the Merger will be duly authorized and,

when issued as contemplated hereby at and after the Effective Time, will be validly issued, fully paid and nonassessable and free of all Restrictions.

(D) In Section 7.01 of the Existing Merger Agreement, subsection (b) is hereby deleted in its entirety, and the following new subsection (b) is hereby inserted in its place:

(b) Promptly after such calculation of the Closing Net Worth, the Surviving Corporation shall deliver to the SPAR Principals written notice of the Closing Net Worth as so calculated (the "Closing Net Worth Notice"). Following the delivery of the Closing Net Worth Notice, the SPAR Principals shall have the right to review the calculation thereof for a period of thirty (30) days after the delivery of the Closing Net Worth Notice to the SPAR Principals (the "Review Period"). If, the SPAR

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Principals do not provide PIA Delaware with written objection to the calculation of the Closing Net Worth prior to the expiration of the Review Period, then, (i) to the extent that the Closing Net Worth, as set forth in the Closing Net Worth Notice, is greater than one million four hundred thirty-six thousand dollars (\$1,436,000) (the "Target Amount"), no adjustment will be made, and the SPAR Principals will have no further obligations hereunder; and (ii) to the extent the Closing Net Worth, as set forth in the Closing Net Worth Notice, is less than the Target Amount, the SPAR Principals shall pay to PIA Delaware, within five (5) business days after the last day of the Review Period, the amount of such shortfall, such payment obligation to be borne by the SPAR Principals pro rata (44/72 by Mr. Brown and 28/72 by Mr. Bartels), and to be satisfied either (at the election of the SPAR Principals) (A) by wire transfer of immediately available funds to such account as PIA Delaware may designate or (B) by corresponding reductions in the loans owed to the SPAR Principals from SMCI.

(E) Exhibit E-1 to the Existing Merger Agreement is hereby inserted in the form annexed hereto as Exhibit 1.

(F) Each of the Parties hereto hereby acknowledges and, to the extent such Party's consent may be required under the Merger Agreement, consents to the First Amendment to Reorganization Agreement, dated as of the date hereof, a copy of which is annexed hereto as Exhibit 2.

Section 2. Counterparts. This Amendment may be signed in two or more counterpart copies of the entire document or of signature pages to the document, each of which may be executed by one or more of the Parties hereto, but all of which, when taken together, shall constitute a single agreement binding upon all of the Parties hereto.

Section 3. Governing Law, Etc. This Amendment is a Merger Document and shall be governed by and construed in accordance with the applicable terms and provisions of Article IX (as well as any applicable definitions or provisions appearing elsewhere) of the Merger Agreement as if this Amendment were the Agreement referred to therein, which terms and provisions are incorporated herein by reference.

Section 4. Agreement to Continue as Amended. The Merger Agreement, as supplemented, modified and amended by this Amendment, shall remain and continue in full force and effect after the date hereof.

[END OF PAGE]

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Section 5. Entire Agreement. This Amendment contains the entire agreement of the Parties and supersedes all other representations, warranties, agreements and understandings, oral or otherwise, among the parties with respect



to the matters contained herein.

IN WITNESS WHEREOF, the Parties hereto have executed and delivered this Amendment as of the date first written above.

PIA MERCHANDISING SERVICES, INC.

SPAR ACQUISITION, INC.

By: /s/ TERRY R. PEETS  
-----  
Name: Terry R. Peets  
Title: President and Chief  
Executive Officer

By: /s/ ROBERT G. BROWN  
-----  
Name: Robert G. Brown  
Title: Chairman, Chief Executive  
Officer and President

SG ACQUISITION, INC.

SPAR MARKETING FORCE, INC.

By: /s/ TERRY R. PEETS  
-----  
Name: Terry R. Peets  
Title: President and Chief  
Executive Officer

By: /s/ ROBERT G. BROWN  
-----  
Name: Robert G. Brown  
Title: Chairman, Chief Executive  
Officer and President

PIA MERCHANDISING CO., INC.

SPAR, INC.

By: /s/ TERRY R. PEETS  
-----  
Name: Terry R. Peets  
Title: President and Chief  
Executive Officer

By: /s/ ROBERT G. BROWN  
-----  
Name: Robert G. Brown  
Title: Chairman, Chief Executive  
Officer and President

SPAR/BURGOYNE RETAIL SERVICES, INC.

SPAR MARKETING, INC.

By: /s/ ROBERT G. BROWN  
-----  
Name: Robert G. Brown  
Title: Chairman, Chief Executive  
Officer and President

By: /s/ ROBERT G. BROWN  
-----  
Name: Robert G. Brown  
Title: Chairman, Chief Executive  
Officer and President

SPAR MCI PERFORMANCE GROUP, INC.

SPAR TRADEMARKS, INC.

By: /s/ ROBERT G. BROWN  
-----  
Name: Robert G. Brown  
Title: Chairman, Chief Executive  
Officer

By: /s/ ROBERT G. BROWN  
-----  
Name: Robert G. Brown  
Title: Chairman, Chief Executive  
Officer and President

SPAR MARKETING, INC., a Nevada corporation

By: /s/ ROBERT G. BROWN  
-----  
Name: Robert G. Brown  
Title: Chairman, Chief Executive  
Officer and President

SPAR MARKETING, INC., a Nevada corporation

By: /s/ ROBERT G. BROWN

-----  
Name: Robert G. Brown  
Title: Chairman, Chief Executive  
Officer and President

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EXHIBIT E-1

EXHIBIT 1 TO FIRST AMENDMENT TO MERGER AGREEMENT

FORM OF REVERSE SPLIT AMENDMENT TO  
PIA DELAWARE CERTIFICATE OF INCORPORATION

Upon this Certificate of Amendment to the Certificate of Incorporation of the Corporation becoming effective pursuant to the General Corporation Law of the State of Delaware (the "Effective Time"), each share of the Corporation=s common stock, par value \$.01 per share (the "Old Common Stock"), issued and outstanding immediately prior to the Effective Time, will be automatically reclassified as and converted into [\_\_\_\_\_] of a share of common stock, par value \$.01 per share, of the Corporation (the "New Common Stock"). Any stock certificate that, immediately prior to the Effective Time, represented shares of the Old Common Stock will, from and after the Effective Time, automatically and without the necessity of presenting the same for exchange, represent the number of shares of the New Common Stock as equals the product obtained by multiplying the number of shares of Old Common Stock represented by such certificate immediately prior to the Effective Time by [\_\_\_\_\_]. No fractional shares of New Common Stock will be issued in connection with the reclassification and conversion of the Old Common Stock into the New Common Stock. In lieu of any fractional shares, each holder of Old Common Stock who would otherwise receive a fractional share of New Common Stock will be entitled to receive cash in an amount equal to the product obtained by multiplying (1) the closing sales price of the Corporation=s Common Stock at the Effective Time as reported on the Nasdaq National Market (or, if applicable, the Nasdaq SmallCap Market or any exchange that the PIA Common Stock may be traded on at the Effective Time) by (2) the number of shares of Old Common Stock held by such holder that would otherwise have been exchanged for such fractional share interest.

FIRST AMENDMENT  
TO  
VOTING AGREEMENT

THIS FIRST AMENDMENT TO VOTING AGREEMENT, dated as of May 14, 1999 (this "Amendment"), is made by and among CLINTON E. OWENS, an individual ("Owens") and RVM/PIA, a California limited partnership ("RVM/PIA") (Owens and RVM/PIA may be referred to individually as a "PIA Stockholder" and collectively as the "PIA Stockholders"), PIA MERCHANDISING SERVICES, INC., a Delaware corporation ("PIA Delaware"), ROBERT G. BROWN, an individual ("Brown") and WILLIAM H. BARTELS, an individual ("Bartels") (Brown and Bartels may be referred to individually as a "SPAR Stockholder" and collectively as the "SPAR Stockholders"), and SPAR ACQUISITION, INC., a Nevada corporation (the "SPAR Acquisition"). The PIA Stockholders, PIA Delaware, the SPAR Stockholders and SPAR Acquisition are sometimes referred to herein individually as a "Party" and collectively as the "Parties".

RECITALS

The PIA Stockholders, PIA Delaware, the SPAR Stockholders and SPAR Acquisition are parties to a Voting Agreement dated as of February 28, 1999, which includes modifications made pursuant to the Page Substitution Amendment to Merger Agreement and Merger Documents among certain of the Parties and others dated as of March 1, 1999 (the "Page Substitution Amendment") (such Voting Agreement, as so modified, the "Existing Voting Agreement", and as modified by this Amendment, and as the same may be supplemented, modified, amended, restated or replaced from time to time in the manner provided therein, the "Voting Agreement"). Capitalized terms used and not otherwise defined or amended in this Amendment shall have the meanings respectively assigned to them in the Voting Agreement or other "Merger Documents" (as defined in the Merger Agreement).

PIA Delaware and certain of its subsidiaries and SPAR Acquisition and certain of its affiliates (which will be subsidiaries at closing) are parties to an Agreement and Plan of Merger dated as of February 28, 1999, which includes modifications made pursuant to the Page Substitution Amendment (as so modified, the "Existing Merger Agreement"), and which will be amended pursuant to the First Amendment to Merger Agreement among the parties thereto dated as of May 14, 1999 (the "First Merger Amendment") (the Existing Merger Agreement, as modified by the First Merger Amendment, and as the same may be supplemented, modified, amended, restated or replaced from time to time in the manner provided therein, the "Merger Agreement").

SPAR Acquisition and the SPAR Stockholders are parties to a Reorganization Agreement dated as of February 28, 1999, which includes modifications made pursuant to the Reorganization Page Substitution Amendment to Merger Agreement and Merger Documents among certain of the Parties and others dated as of March 1999 (the "Reorganization Page Substitution Amendment") (such Reorganization Agreement, as so modified, the "Existing Reorganization Agreement"), and which will be amended pursuant to the First Amendment to Reorganization Agreement among the parties thereto dated as of May 14, 1999 (the "First Reorganization Amendment") (the Existing Reorganization Agreement, as modified by the First Reorganization Amendment, and as the same may be supplemented, modified, amended, restated or replaced from time to time in the manner provided therein, the "Reorganization Agreement").

The Parties have each determined that it is in its best interest to amend the Existing Voting Agreement as provided below, and have entered into this Amendment in order to do so, all upon the terms and provisions and subject to the conditions hereinafter set forth.

AGREEMENT

In consideration of the foregoing, the mutual covenants and agreements hereinafter set forth and other good and valuable consideration (the receipt and adequacy of which are hereby acknowledged by the parties), the parties hereto hereby agree as follows:

Section 1. Amendment to Existing Voting Agreement. The Existing Voting Agreement is hereby supplemented and amended as follows, effective as of the date first written above:

(A) The PIA Stockholders, PIA Delaware, the SPAR Stockholders and SPAR Acquisition each hereby confirm their consent to, and agree to be bound by the pages substituted in the Voting Agreement by, the Page Substitution Amendment, a copy of which is annexed hereto as Exhibit A.

(B) The PIA Stockholders, PIA Delaware, the SPAR Stockholders and SPAR Acquisition each hereby acknowledges and, to the extent such Party's consent may be required under the Voting Agreement, consents to the Reorganization Page Substitution Amendment, a copy of which is annexed hereto as Exhibit B.

(C) The PIA Stockholders, PIA Delaware, the SPAR Stockholders and SPAR Acquisition each hereby acknowledges and, to the extent such Party's consent may be required under the Voting Agreement, consents to the First Merger Amendment, a copy of which is annexed hereto as Exhibit C.

(D) The PIA Stockholders, PIA Delaware, the SPAR Stockholders and SPAR Acquisition each hereby acknowledges and, to the extent such Party's consent may be required under the Voting Agreement, consents to the First Merger Amendment, a copy of which is annexed hereto as Exhibit D.

(E) In Section 1 of the Existing Voting Agreement, subsection (b) is hereby deleted in its entirety, and the following new subsection (b) is hereby inserted in its place:

(b) vote or cause the vote of the PIA Shares held of record by such PIA Stockholder, at each such meeting held before the Effective Time and with respect to each written consent, (i) to approve the Merger Agreement and the Merger, the Proposed PIA Certificate of Amendment (i.e., Charter Amendment No. 1, Charter Amendment No. 2, Charter Amendment No. 3, and the Reverse Split Proposal, as such terms are defined in the PIA Proxy Statement), the Option Plan Amendment, and any action(s) in furtherance thereof, (ii) except as otherwise approved in writing in advance by SPAR Acquisition (which approval may be granted, withheld, conditioned or delayed in its sole discretion), against any Acquisition Proposal (other than the Merger), and (iii) in favor of any amendment to or restatement of the charter or by-laws of PIA Delaware required by the Merger Agreement, and except as otherwise approved in writing in advance by SPAR Acquisition (which approval may be granted, withheld, conditioned or delayed in its sole discretion), against any other amendment to or restatement of the charter or by-laws of PIA Delaware.

Section 2. Counterparts. This Amendment may be signed in two or more counterpart copies of the entire document or of signature pages to the document, each of which may be executed by one or more of the Parties hereto, but all of which, when taken together, shall constitute a single agreement binding upon all of the Parties hereto.

Section 3. Governing Law, Etc. This Amendment shall be governed by and construed in accordance with the applicable terms and provisions of Sections 10 through 17 (as well as any applicable definitions or provisions appearing elsewhere) of the Voting Agreement as if this Amendment were the Agreement referred to therein, which terms and provisions are incorporated herein by reference.

Section 4. Agreement to Continue as Amended. The Voting Agreement, as supplemented, modified and amended by this Amendment, shall remain and continue in full force and effect after the date hereof.

[END OF PAGE]

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Section 5. Entire Agreement. This Amendment contains the entire agreement of the Parties and supersedes all other representations, warranties, agreements and understandings, oral or otherwise, among the parties with respect to the matters contained herein.

IN WITNESS WHEREOF, the Parties hereto have executed and delivered this Amendment as of the date first written above.

PIA MERCHANDISING SERVICES, INC.

/s/ CLINTON E. OWENS  
-----  
Clinton E. Owens

By: /s/ CATHY L. WOOD  
-----  
Name: Cathy L. Wood  
Title: Chief Financial  
Officer

RVM/PIA, A CALIFORNIA LIMITED PARTNERSHIP  
By: Riordan, Lewis & Haden  
Its: General Partner

SPAR ACQUISITION, INC.

By: /s/ J. CHRISTOPHER LEWIS  
-----  
Name: J. Christopher Lewis  
Its: General Partner

By: /s/ ROBERT G. BROWN  
-----  
Name: Robert G. Brown  
Title: Chairman, Chief  
Executive Officer and  
President

/s/ ROBERT G. BROWN  
-----  
Robert G. Brown

/s/ WILLIAM H. BARTELS  
-----  
William H. Bartels

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## INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement No. 333-07377 of PIA Merchandising Services, Inc. on Form S-8 of our report dated February 18, 1999, appearing in this Annual Report on Form 10-K/A of PIA Merchandising Services, Inc. for the year ended January 1, 1999.

/s/ Deloitte & Touche LLP

Costa Mesa, California  
May 20, 1999