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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2017

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 000—36149

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**STG Group, Inc.**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

11091 Sunset Hills Road, Suite 200  
Reston, Virginia  
(Address of principal executive offices)

46-3134302  
(I.R.S. Employer  
Identification No.)

20190  
(Zip Code)

Registrant's telephone number, including area code: (703) 691-2480

Not Applicable

(Former name or former address, if changed since last report)

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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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller Reporting Company	<input checked="" type="checkbox"/>
		Emerging growth company	<input checked="" type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

As of August 6, 2017, there were 16,625,849 shares outstanding of the registrant's common stock.

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STG Group, Inc.

**Condensed Consolidated Balance Sheets**  
**June 30, 2017 (Unaudited) and December 31, 2016**  
*(In Thousands, Except Share and Per Share Amounts)*

	June 30, 2017	December 31, 2016
<b>Assets</b>		
Current Assets		
Cash and cash equivalents	\$ 1,418	\$ 7,841
Contract receivables, net	29,180	28,784
Investments held in Rabbi Trust	447	332
Prepaid expenses and other current assets	2,302	2,294
<b>Total current assets</b>	<u>33,347</u>	<u>39,251</u>
Property and equipment, net	1,057	1,157
Goodwill	51,176	72,313
Intangible assets, net	28,716	31,984
Other assets	423	423
<b>Total assets</b>	<u>\$ 114,719</u>	<u>\$ 145,128</u>
<b>Liabilities and Stockholders' Equity</b>		
Current Liabilities		
Current portion of long-term debt, net of discount	\$ 70,831	\$ 4,496
Accounts payable and accrued expenses	14,325	11,683
Accrued payroll and related liabilities	6,440	6,391
Billings in excess of revenue recognized	679	688
Deferred compensation plan	447	332
Deferred rent	100	228
<b>Total current liabilities</b>	<u>92,822</u>	<u>23,818</u>
Long-term debt, net of current portion and discount	-	67,694
Deferred income taxes	1,018	6,354
Deferred rent	742	743
<b>Total liabilities</b>	<u>94,582</u>	<u>98,609</u>
Commitments and Contingencies		
Stockholders' Equity		
Preferred stock; \$0.0001 par value; 10,000,000 shares authorized; none issued and outstanding	-	-
Common stock; \$0.0001 par value; 100,000,000 shares authorized; 16,625,849 and 16,603,449 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	2	2
Additional paid-in capital	103,473	102,920
Accumulated deficit	(83,338)	(56,403)
<b>Total stockholders' equity</b>	<u>20,137</u>	<u>46,519</u>
<b>Total liabilities and stockholders' equity</b>	<u>\$ 114,719</u>	<u>\$ 145,128</u>

See accompanying notes to the condensed consolidated financial statements.

STG Group, Inc.

**Unaudited Condensed Consolidated Statements of Operations**  
**Three and Six Months Ended June 30, 2017 and 2016**  
*(In Thousands, Except Share and Per Share Amounts)*

	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Contract revenue	\$ 33,757	\$ 40,918	\$ 69,535	\$ 81,524
Direct expenses	<u>22,966</u>	<u>27,675</u>	<u>46,681</u>	<u>55,136</u>
<b>Gross profit</b>	10,791	13,243	22,854	26,388
Indirect and selling expenses	14,225	13,254	29,138	25,957
Impairment of goodwill	<u>21,137</u>	<u>-</u>	<u>21,137</u>	<u>-</u>
<b>Operating (loss) income</b>	<u>(24,571)</u>	<u>(11)</u>	<u>(27,421)</u>	<u>431</u>
Other income (expense)				
Other income (expense), net	16	5	34	(393)
Interest expense	<u>(2,445)</u>	<u>(2,150)</u>	<u>(4,870)</u>	<u>(4,312)</u>
	<u>(2,429)</u>	<u>(2,145)</u>	<u>(4,836)</u>	<u>(4,705)</u>
<b>Loss before income taxes</b>	(27,000)	(2,156)	(32,257)	(4,274)
Income tax benefit	<u>(3,440)</u>	<u>(839)</u>	<u>(5,322)</u>	<u>(1,488)</u>
<b>Net loss</b>	<u>\$ (23,560)</u>	<u>\$ (1,317)</u>	<u>\$ (26,935)</u>	<u>\$ (2,786)</u>
Net loss per share available to common stockholders				
Basic and diluted	<u>\$ (1.42)</u>	<u>\$ (0.08)</u>	<u>\$ (1.62)</u>	<u>\$ (0.17)</u>
Weighted average number of common shares outstanding				
Basic and diluted	<u>16,605,463</u>	<u>16,107,933</u>	<u>16,604,456</u>	<u>16,107,504</u>

See accompanying notes to the condensed consolidated financial statements.

**STG Group, Inc.**

**Unaudited Condensed Consolidated Statements of Cash Flows**  
**Six Months Ended June 30, 2017 and 2016**  
*(In Thousands)*

	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
<b>Cash Flows From Operating Activities</b>		
Net loss	\$ (26,935)	\$ (2,786)
Adjustments to reconcile net loss to net cash used in operating activities:		
Deferred taxes	(5,336)	(1,528)
Bad debt recoveries	18	(191)
Deferred rent	(129)	117
Amortization of deferred financing costs	685	709
Depreciation and amortization of property and equipment	239	278
Amortization of intangible assets	3,268	3,502
Stock-based compensation	553	266
Impairment of goodwill	21,137	-
Changes in assets and liabilities:		
(Increase) decrease in:		
Contract receivables	(414)	5,008
Prepaid expenses and other current assets	(8)	(1,220)
Other assets	-	9
Increase (decrease) in:		
Accounts payable and accrued expenses	2,642	(2,369)
Accrued payroll and related liabilities	49	(967)
Deferred compensation plan	83	(3,924)
Billings in excess of revenue recognized	(9)	(92)
<b>Net cash used in operating activities</b>	<u>(4,157)</u>	<u>(3,188)</u>
<b>Cash Flows From Investing Activities</b>		
Proceeds from sales of investments held in Rabbi Trust	-	3,924
Purchase of investments held in Rabbi Trust	(83)	-
Purchases of property and equipment	(139)	(7)
<b>Net cash (used in) provided by investing activities</b>	<u>(222)</u>	<u>3,917</u>
<b>Cash Flows From Financing Activities</b>		
Payments on long-term debt	(2,044)	(1,022)
<b>Net cash used in financing activities</b>	<u>(2,044)</u>	<u>(1,022)</u>
<b>Net decrease in cash and cash equivalents</b>	(6,423)	(293)
<b>Cash and Cash Equivalents</b>		
Beginning	7,841	8,503
Ending	<u>\$ 1,418</u>	<u>\$ 8,210</u>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid for interest	<u>\$ 4,185</u>	<u>\$ 3,603</u>
Cash paid for income taxes	<u>\$ 18</u>	<u>\$ 597</u>
<b>Supplemental Disclosures of Non-Cash Investing Activities</b>		
Change in investments held in Rabbi Trust	<u>\$ (32)</u>	<u>\$ (398)</u>
Change in deferred compensation plan	<u>\$ 32</u>	<u>\$ 398</u>

See accompanying notes to the condensed consolidated financial statements.

**STG Group, Inc.**

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

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**Note 1. Nature of Business and Significant Accounting Policies**

**Nature of business:** STG Group, Inc. (formerly, Global Defense & National Security Systems, Inc. or GDEF) and its subsidiaries (collectively, the Company) was originally incorporated in Delaware on July 3, 2013 as a blank check company, with Global Defense & National Security Holdings LLC (“Global Defense LLC” or the “Sponsor”) as Sponsor, formed for the purpose of effecting a merger, capital stock exchange, asset acquisition, stock purchase, reorganization, exchangeable share transaction or other similar business combination. On November 23, 2015, the Company consummated its business combination with STG Group Holdings, Inc. (formerly, STG Group, Inc. or “STG Group”) pursuant to the stock purchase agreement, dated as of June 8, 2015, which provided for the purchase of all the capital stock of STG Group by the Company (the “Business Combination”). In connection with the closing of the Business Combination, the Company ceased to be a shell company in accordance with its Amended and Restated Certificate of Incorporation. The Company also changed its name from Global Defense & National Security Systems, Inc. to STG Group, Inc. The Company’s common stock trades over-the-counter on the OTCQB exchange, under the symbol “STGG”.

The Company provides enterprise engineering, telecommunications, information management and security products and services to the federal government and commercial businesses. Segment information is not presented since all of the Company’s revenue is attributed to a single reportable segment.

**Basis of presentation:** The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles for interim financial reporting and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. For additional information, including the Company’s significant accounting policies, refer to the consolidated financial statements and related footnotes in the Company’s consolidated financial statements included in the Company’s Annual Report on Form 10-K as of and for the year ended December 31, 2016.

**STG Group, Inc.**

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

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**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

In the opinion of management, all adjustments considered necessary for a fair statement of financial results have been made. Such adjustments consist of only those of a normal recurring nature. Operating results for the three and six months ended June 30, 2017 and 2016, are not necessarily indicative of the results that may be expected for the entire fiscal year.

Figures are expressed in thousands of dollars unless otherwise indicated.

**Use of estimates:** The preparation of financial statements 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 consolidated financial statements. Actual results could differ from those estimates.

Significant estimates embedded in the consolidated financial statements for the periods presented include revenue recognition on fixed-price contracts, the allowance for doubtful accounts, the valuation and useful lives of intangible assets, the length of certain customer relationships, useful lives of property, plant and equipment, valuation of a Rabbi Trust and related deferred compensation liability. Estimates and assumptions are also used when determining the allocation of the purchase price in a business combination to the fair value of assets and liabilities and determining related useful lives.

**Going concern:** The accompanying consolidated financial statements have been prepared using the going concern basis of accounting, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

The Company was not in compliance with its financial covenants related to the consolidated EBITDA and the senior secured leverage ratio under the Credit Agreement among the Company, MC Admin Co LLC (the "Lender") and the other lenders party thereto (the "Credit Agreement") at September 30, 2016, December 31, 2016, March 31, 2017, and June 30, 2017, and was also not in compliance with its financial covenant related to the fixed charge coverage ratio under the Credit Agreement (collectively with the consolidated EBITDA and senior secured leverage ratio covenants, the "Specified Financial Covenants") at June 30, 2017. At September 30, 2016, the non-compliance was cured by raising equity from stockholders ("Equity Cure") as was allowed by the Credit Agreement. At December 31, 2016 the Company received a forbearance which expired on March 31, 2017. The Company then entered into a Limited Waiver ("the Waiver") from MC Admin Co LLC and other lenders under the Credit Agreement as of March 31, 2017, pursuant to which the lenders waived the Company's non-compliance with the covenants related to the consolidated EBITDA, and the senior secured leverage ratio as of December 31, 2016. Pursuant to the Waiver:

- Loans under the Credit Agreement are subject to additional interest at a rate of 2% per annum until the earliest of (x) the date on which all loans are repaid and all commitments under the Credit Agreement are terminated, (y) the date the Company delivers the financial statements and certificates for the quarter ending March 31, 2017 showing that they are not in default under the Credit Agreement or (z) the date on which default interest is otherwise due under the Credit Agreement;

## STG Group, Inc.

### Notes to the Consolidated Financial Statements

(In thousands, except share and per share amounts)(Unaudited)

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#### Note 1. Nature of Business and Significant Accounting Policies (Continued)

- The Company must obtain lender consent prior to use of its revolving credit facility; and
- The Company could not effect a Cure Right with respect to the quarter ending March 31, 2017.

The Company was not in compliance with the covenants related to the consolidated EBITDA and the senior secured leverage ratio for quarter ended March 31, 2017 and was not in compliance with the Specified Financial Covenants for the quarter ended June 30, 2017. The Lender has not granted a waiver for the covenant violations as of March 31, 2017 and June 30, 2017. Without a waiver or other relief under the Credit Agreement, one of the remedies the Lender has available to it, amongst others, is the ability to accelerate repayment of the debt, which the Company would not be able to immediately repay.

If the business continues to perform at the current level through the next quarter, the Company does not expect to satisfy the Specified Financial Covenants at that time, and it is likely that the Company will be in non-compliance at September 30, 2017. The Company's inability to meet the required covenant levels could have a material adverse impact to the Company, including the need for the Company to effect an additional Cure Right or obtain additional forbearance or an amendment, waiver, or other changes in the Credit Agreement. The Credit Agreement does not allow the Company to exercise the Cure Right in consecutive fiscal quarters, more than three fiscal quarters in the aggregate, or in more than two of any four fiscal quarters. The amount allowed under the Cure Right may not exceed the lesser of \$2.5 million and 20% of consolidated EBITDA. The aggregate of Cure Rights may not exceed \$5 million.

The Lender's not having granted a waiver or other relief from the Lender and the potential acceleration of the debt by the Lender resulted in the reclassification of debt from a long-term liability to a current liability as of March 31, 2017 and June 30, 2017.

Even if the Lender does grant forbearance or an amendment to or waiver under the Credit Agreement, any future covenant non-compliance could give rise to an event of default thereunder.

In addition, on May 18, 2017, the Company received a notice of default (the "Default Notice") from MC Admin Co LLC ("MC Admin") that states the Company was in default under the Credit Agreement for failing to deliver an annual budget to the lenders on January 15, 2017 as required by the Credit Agreement (the "Budget Delivery Default"). The Company believes this notice is incorrect, as the Company previously provided the required information to the lenders on February 7, 2017. The Default Notice stated that MC Admin was not taking action to enforce the lenders' rights under the Credit Agreement at this time, although it also provided that, as a result of the default, the lenders had no obligations under the Credit Agreement to provide any additional loans or letters of credit. The Lender has not granted a waiver or other relief from the Budget Delivery Default.

The potential acceleration of the loan repayment due to the Lender not providing a waiver required the Company to evaluate whether there is substantial doubt regarding the Company's ability to continue as a going concern.

Management's Plan to alleviate this condition is as follows:

1. Identify, qualify, and win new business to increase revenue and profits,
2. Raise additional equity which would be used to reduce the loan, or
3. Renegotiate the current Credit Agreement to obtain relief from the existing financial covenants and other terms.

As discussed in our Form 10-Q for the quarter ended March 31, 2017, based on the facts that existed as of December 31, 2016, management determined that it was probable that the condition giving rise to the going concern evaluation had been sufficiently alleviated as of December 31, 2016. However, the Lender has not currently granted a waiver or other relief for the Budget Delivery Default or the financial covenant violations as of March 31, 2017 or June 30, 2017. Consequently, management has changed our assessment regarding the potential acceleration of the loan repayment made as of December 31, 2016. As the Lender has not currently granted a waiver or other form of relief for the financial covenant violations as of March 31, 2017 or June 30, 2017, and as disclosed above, sent us a default letter on May 18, 2017, there exists substantial doubt about our ability to continue as a going concern, in the event the Lender exercises its rights to accelerate the repayment of the loan.

These consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets and liabilities that may result in the Company not being able to continue as a going concern.

**Revenue recognition:** Revenue is recognized when persuasive evidence of an arrangement exists, services have been rendered or goods delivered, the contract price is fixed or determinable and collectability is reasonably assured. Revenue associated with work performed prior to the completion and signing of contract documents is recognized only when it can be reliably estimated and realization is probable. The Company bases its estimates on previous experiences with the customer, communications with the customer regarding funding status and its knowledge of available funding for the contract.

Revenue on cost-plus-fee contracts is recognized to the extent of costs incurred plus a proportionate amount of the fee earned. The Company considers fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs incurred in performance of the contract. The Company considers performance-based fees, including award fees, under any contract type to be earned when it can demonstrate satisfaction of performance goals, based upon historical experience, or when the Company receives contractual notification from the customer that the fee has been earned. Revenue on time-and-materials contracts is recognized based on the hours incurred at the negotiated contract billing rates, plus the cost of any allowable material costs and out-of-pocket expenses. Revenue on fixed-price contracts is primarily recognized using the proportional performance method of contract accounting. Unless it is determined as part of the Company's regular contract performance review that overall progress on a contract is not consistent with costs expended to date, the Company determines the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected upon completion of the contract. Revenue on other fixed-price service contracts is generally recognized on a straight-line basis over the contractual service period,

unless the revenue is earned, or obligations fulfilled, in a different manner.

Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined and are recorded as forward loss liabilities in the consolidated financial statements. Changes in job performance, job conditions and estimated profitability may result in revisions to costs and revenue and are recognized in the period in which the revisions are determined.

**STG Group, Inc.**

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

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**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

Multiple agencies of the federal government directly or indirectly provided the majority of the Company's contract revenue during the six months ended June 30, 2017 and 2016. For the six months ended June 30, 2017 and 2016, there were two customers that each provided revenue in excess of 10% of total revenue. These customers accounted for approximately 82% and 80% respectively, of the Company's total revenue for the six months ended June 30, 2017 and 2016, respectively. The same customers accounted for approximately 83% and 80% of the Company's total revenue for the three months ended June 30, 2017 and 2016, respectively.

Federal government contract costs, including indirect costs, are subject to audit and adjustment by the Defense Contract Audit Agency. Contract revenue has been recorded in amounts that are expected to be realized upon final settlement.

**Costs of revenue:** Costs of revenue include all direct contract costs, as well as indirect overhead costs and selling, general and administrative expenses that are allowable and allocable to contracts under federal procurement standards. Costs of revenue also include costs and expenses that are unallowable under applicable procurement standards and are not allocable to contracts for billing purposes. Such costs and expenses do not directly generate revenue, but are necessary for business operations.

There was one vendor that comprised approximately 11% of total direct expenses for the three and six months ended June 30, 2017 and approximately 11% and 12% of total direct expenses for the three and six months ended June 30, 2016, respectively.

**Investments held in Rabbi Trust:** The Company has investments in mutual funds held in a Rabbi Trust that are classified as trading securities. Management determines the appropriate classification of the securities at the time they are acquired and evaluates the appropriateness of such classifications at each balance sheet date. The securities are classified as trading securities because they are held for resale in anticipation of short-term (generally 90 days or less) fluctuations in market prices. The trading securities are stated at fair value. Realized and unrealized gains and losses and other investment income are included in other income (expense) in the accompanying condensed consolidated statements of operations.

**Contract receivables:** Contract receivables are generated primarily from prime and subcontracting arrangements with federal governmental agencies. Billed contract receivables represent invoices that have been prepared based on contract terms and sent to the customer. Billed accounts receivable are considered past due if the invoice has been outstanding more than 30 days. The Company does not charge interest on accounts receivable; however, federal governmental agencies may pay interest on invoices outstanding more than 30 days. The Company records interest income from federal governmental agencies when received. All contract receivables are on an unsecured basis.

Unbilled amounts represent costs and anticipated profits awaiting milestones to bill, contract retainages, award fees and fee withholdings, as well as amounts currently billable.

In accordance with industry practice, contract receivables relating to long-term contracts are classified as current, even though portions of these amounts may not be realized within one year.

Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history and current economic conditions. Management has recorded an allowance for contract receivables that are considered to be uncollectible. Both billed and unbilled receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received.

Notes to the Consolidated Financial Statements

(In thousands, except share and per share amounts)(Unaudited)

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**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

**Valuation of long-lived assets:** The Company accounts for the valuation of long-lived assets, including amortizable intangible assets, under authoritative guidance issued by the Financial Accounting Standards Board (FASB), which requires that long-lived assets and certain intangible assets be reviewed for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the long-lived assets is measured by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

During the three months ended June 30, 2017, the Company performed an interim impairment test of its intangible assets and concluded that no impairment existed. During the three and six months ended June 30, 2016 there were no adverse changes in long-lived assets which caused a need for an impairment analysis.

**Identifiable intangible assets:** Intangible assets of the Company are comprised of customer relationships and a trade name acquired as a result of the Business Combination. The Company determined that the customer relationships and trade name represent finite-lived intangible assets with useful lives of eight and fifteen years, respectively. The assets are being amortized proportionately over the term of their useful lives based on the estimated economic benefit derived over the course of the asset life.

**Goodwill:** The Company records the excess of the purchase price of an acquired company over the fair value of the identifiable net assets acquired as goodwill. In accordance with authoritative guidance issued by the FASB, entities can elect to use a qualitative approach to test goodwill for impairment. Under this approach, the Company performs a qualitative assessment (Step Zero) to determine whether it is more-likely-than-not that the fair value of the reporting unit is less than the carrying value. Prior to the adoption of ASU 2017-04, if the fair value of the reporting unit was less than the carrying value of the reporting unit, the Company was required to perform a goodwill impairment test using a two-step approach, which was performed at the reporting unit level. In the second step, the implied value of the goodwill was estimated at the fair value of the reporting unit, less the fair value of all other tangible and identifiable intangible assets of the reporting unit. If the carrying amount of the goodwill exceeded the implied fair value of the goodwill, an impairment charge was recognized in the amount equal to that excess, not to exceed the carrying amount of the goodwill. If the fair value of the reporting unit was not less than the carrying value of the reporting unit, the two-step goodwill test was not required.

During the second quarter of 2017, the Company early adopted ASU 2017-04, *Intangibles-Goodwill and Other (Topic 350) Simplifying the Test for Goodwill Impairment*. In accordance with the guidance in ASU 2017-04, an entity should perform its annual or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units and determination of the fair value of each reporting unit. The fair value of a reporting unit is estimated using a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for the business, estimation of the useful life over which cash flows will occur and determination of the weighted-average cost of capital. This discounted cash flow analysis is corroborated by a top-down analysis, including a market assessment of enterprise value.

The Company has elected to perform its annual analysis on December 31 each year at the reporting unit level and, as of the Closing Date of the Business Combination, the Company determined that there was one reporting unit. During the six months ended June 30, 2017, the Company was unable to achieve its targeted revenue and profit forecasts; therefore, the Company recorded an impairment charge on goodwill of \$21.1 million. If the Company is unable to achieve revenue growth and increased profitability, future impairment tests may result in an additional goodwill impairment charge, which could be material.

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

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**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

**Income taxes:** The Company accounts for income taxes under FASB ASC Topic 740, *Income Taxes* (ASC 740). At the end of each interim period, the Company estimates an annualized effective tax rate expected for the full year based on the most recent forecast of pre-tax income, permanent book and tax differences, and tax planning strategies. The Company uses this effective rate to provide for income taxes on a year-to-date basis, excluding the effect of significant, unusual, discrete or extraordinary items, and items that are reported net of their related tax effects. The Company records the tax effect of significant, unusual, discrete or extraordinary items, and items that are reported net of their tax effects in the period in which they occur.

In accordance with authoritative guidance on accounting for uncertainty in income taxes issued by the FASB, management has evaluated the Company's tax positions and has concluded that the Company has taken no uncertain tax positions that require adjustment to the quarterly condensed consolidated financial statements to comply with the provisions of this guidance.

Interest and penalties related to tax matters are recognized in expense. There was no accrued interest or penalties recorded during the six months ended June 30, 2017 and 2016.

**Fair value of financial instruments** The carrying value of the Company's cash and cash equivalents, contract receivables, line-of-credit, accounts payable and other short-term liabilities are believed to approximate fair value as of June 30, 2017 and December 31, 2016, respectively, because of the relatively short duration of these instruments. The Company also assessed long-term debt and determined that such amounts approximated fair value primarily since its terms and interest approximate current market terms for a comparable market participant and was negotiated with an unrelated third party lender. The Company considers the inputs related to these estimates to be Level 2 fair value measurements.

Certain assets and liabilities are recorded at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability between market participants in an orderly transaction on the measurement date. The market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability is known as the principal market. When no principal market exists, the most advantageous market is used. This is the market in which the reporting entity would sell the asset or transfer the liability with the price that maximizes the amount that would be received or minimizes the amount that would be paid. Fair value is based on assumptions market participants would make in pricing the asset or liability. Generally, fair value is based on observable quoted market prices or derived from observable market data when such market prices or data are available. When such prices or inputs are not available, the reporting entity should use valuation models.

The Company's assets recorded at fair value on a recurring basis are categorized based on the priority of the inputs used to measure fair value. Fair value measurement standards require an entity to maximize the use of observable inputs (such as quoted prices in active markets) and minimize the use of unobservable inputs (such as appraisals or other valuation techniques) to determine fair value. The inputs used in measuring fair value are categorized into three levels, as follows:

Level 1: Inputs that are based upon quoted prices for identical instruments traded in active markets.

Level 2: Inputs that are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar investments in markets that are not active, or models based on valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the investment.

Level 3: Inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models and similar techniques. As of June 30, 2017 and December 31, 2016, the Company has no financial assets or liabilities that are categorized as Level 3.

**STG Group, Inc.**

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

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**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

The Company has investments carried at fair value in mutual funds held in a Rabbi Trust, which is included in investments held in Rabbi Trust on the accompanying condensed consolidated balance sheets. The Company does not measure non-financial assets and liabilities at fair value unless there is an event which requires this measurement.

**Financial credit risk:** The Company's assets that are exposed to credit risk consist primarily of cash and cash equivalents, investments held in Rabbi Trust and contract receivables. Cash and cash equivalents are deposited with high-credit, quality financial institutions whose balances may, at times, exceed federally insured limits. The Company has not experienced any losses in such amounts and believes that it is not exposed to any significant credit risk on cash and cash equivalents. Investments held in Rabbi Trust are stated at fair value at each reporting period and are subject to market fluctuations. Contract receivables consist primarily of amounts due from various agencies of the federal government or prime contractors doing business with the federal government. Historically, the Company has not experienced significant losses related to contract receivables and, therefore, believes that the credit risk related to contract receivables is minimal.

**Debt issuance costs:** The Company applies the provisions of Accounting Standards Update (ASU) 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. Therefore, financing costs incurred for fees paid to lenders and other parties in connection with debt issuances are recorded as a deduction against the related debt agreement and amortized by the effective interest method over the terms of the related financing arrangements. In connection with the term loan described further in Note 6, the Company recorded amortization of \$0.3 million and \$0.7 million for the three and six months ended June 30, 2017, respectively, and \$0.4 million and \$0.7 million for the three and six months ended June 30, 2016, respectively, which is included in interest expense.

**Stock based compensation:** The Company measures compensation expense for stock based equity awards based on the fair value of the awards on the grant date. Compensation is recognized as expense in the accompanying condensed consolidated statements of operations ratably over the required service period or, for performance based awards, when the achievement of the performance targets become probable.

**Net loss per share:** Basic net loss per share available to common stockholders of the Company is calculated by dividing the net loss by the weighted average number of common shares outstanding during the period. Common shares issuable upon exercise of the stock options and future vesting of the restricted stock awards (see Note 11) have not been included in the computation because their inclusion would have had an antidilutive effect for all periods presented.

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

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**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

**Recent accounting pronouncements:** We consider the applicability and impact of all ASUs. ASUs not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on our condensed consolidated financial position or results of operations.

**New Accounting Pronouncements Adopted**

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting (ASU 2016-09)*. ASU 2016-09 is intended to simplify several aspects of accounting for share-based payment awards, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For example, the new guidance requires all excess tax benefits and tax deficiencies related to share-based payments to be recognized in income tax expense, and for those excess tax benefits to be recognized regardless of whether it reduces current taxes payable. The ASU also allows an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures as they occur. These amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Therefore, the effective date was the first quarter of 2017. The adoption of this new standard did not have a material impact on the condensed consolidated financial statements. The Company made a policy election to account for forfeitures as they occur.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles-Goodwill and Other (Topic 350) Simplifying the Test for Goodwill Impairment*. ASU 2017-04 provides guidance to simplify the subsequent measurement of goodwill by eliminating the Step 2 procedure from the goodwill impairment test. Under the updates in ASU 2017-04, an entity should perform its annual or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendments of this ASU are effective for annual or any interim goodwill impairment tests beginning after December 15, 2019. The Company has early adopted this ASU during the second quarter of 2017.

**New Accounting Pronouncements Not Yet Adopted**

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which establishes a comprehensive revenue recognition standard for virtually all industries under GAAP, including those that previously followed industry-specific guidance. Under the guidance, all entities should recognize revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additionally, various updates have been issued during 2015 and 2016 to clarify the guidance in Topic 606. The guidance is effective for the Company in the first quarter of 2018 using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). We are currently in the process of evaluating the impact of the adoption of this ASU on our consolidated financial statements and our method of adoption. The adoption is expected to impact our revenue recognition and related disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The standard impacts both lessors and lessees. The most significant change for lessees is that the requirement to recognize right-to-use assets and lease liabilities for all leases not considered short term. The guidance is effective for fiscal years beginning after December 15, 2018, and will be applied on a modified retrospective basis. The Company is currently evaluating the impact of the adoption of this standard on the condensed consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments (ASU 2016-13)*. ASU 2016-13 will replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments affect loans, debt securities, trade receivables, net investments in leases, off balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. ASU 2016-13 will be effective for the Company beginning in the first quarter of fiscal year 2020, and early adoption is permitted but not earlier than fiscal year 2019. The Company does not expect the adoption of ASU 2016-13 to have a material impact on its condensed consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. The amendments in this update clarify the guidance regarding the classification of operating, investing, and financing activities for certain types of cash receipts and payments. The amendments in this update are effective for the annual periods, and the interim periods within those years, beginning after December 15, 2017, and should be applied using a retrospective transition method to each period presented. Early adoption is permitted. The Company is evaluating the impact of adoption, if any, to the condensed consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)*, which provides guidance on the presentation of restricted cash or restricted cash equivalents in the statement of cash flows. These amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Company is currently evaluating the impact of the adoption of this guidance on its condensed consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805) Clarifying the Definition of a Business*, which amends the guidance of FASB Accounting Standards Codification (ASC) Topic 805, *Business Combinations*, adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. This guidance is effective for annual and interim periods beginning after December 15, 2017, and early adoption is permitted under certain circumstances. The Company is currently evaluating the impact of the adoption of this guidance on its condensed consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting*. ASU 2017-09

provides guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. This ASU is effective for all entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for reporting periods for which financial statements have not yet been issued. The Company has not yet evaluated the impact, if any, that the adoption of ASU 2017-09 will have on the condensed consolidated financial statements.

**STG Group, Inc.**

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

**Note 2. Contract Receivables and Billings in Excess of Revenue Recognized**

At June 30, 2017 and December 31, 2016, contract receivables consist of the following (in thousands):

	<u>June 30, 2017</u>	<u>December 31, 2016</u>
Billed accounts receivable	\$ 16,489	\$ 21,588
Unbilled accounts receivable	12,775	7,262
	<u>29,264</u>	<u>28,850</u>
Less: allowance for doubtful accounts	(84)	(66)
	<u>\$ 29,180</u>	<u>\$ 28,784</u>

Billings in excess of revenue recognized as of June 30, 2017 and December 31, 2016, are comprised primarily of billings from firm fixed-price contacts, where revenue is recognized in accordance with the proportional performance method.

**Note 3. Property and Equipment**

At June 30, 2017 and December 31, 2016, property and equipment consists of the following (in thousands):

	<u>Estimated Life</u>	<u>June 30, 2017</u>	<u>December 31, 2016</u>
Leasehold improvements	Life of lease	\$ 1,324	\$ 1,324
Computer hardware and software	1 - 3 years	464	329
Office furniture and equipment	1 - 7 years	114	110
		<u>1,902</u>	<u>1,763</u>
Less: accumulated depreciation and amortization		(845)	(606)
		<u>\$ 1,057</u>	<u>\$ 1,157</u>

Depreciation and amortization expense on property and equipment totaled \$0.1 million and \$0.2 million, respectively, for the three and six months ended June 30, 2017 and \$0.1 million and \$0.3 million, respectively, for the three and six months ended June 30, 2016.

**STG Group, Inc.****Notes to the Consolidated Financial Statements***(In thousands, except share and per share amounts)(Unaudited)***Note 4. Intangible Assets**

Identifiable intangible assets as of June 30, 2017, consist of the following (in thousands):

	June 30, 2017			
	Estimated Life	Cost	Accumulated Amortization	Net
Customer relationships	8 years	\$ 26,380	\$ 8,672	\$ 17,708
Trade name	15 years	13,460	2,452	11,008
		<u>\$ 39,840</u>	<u>\$ 11,124</u>	<u>\$ 28,716</u>

Identifiable intangible assets as of December 31, 2016, consist of the following (in thousands):

	December 31, 2016			
	Estimated Life	Cost	Accumulated Amortization	Net
Customer relationships	8 years	\$ 26,380	\$ 6,136	\$ 20,244
Trade name	15 years	13,460	1,720	11,740
		<u>\$ 39,840</u>	<u>\$ 7,856</u>	<u>\$ 31,984</u>

Amortization expense amounted to \$1.6 million and \$3.3 million, respectively, for the three and six months ended June 30, 2017 and \$1.8 million and \$3.5 million, respectively, for the three and six months ended June 30, 2016. During the three months ended June 30, 2017, the Company performed an interim impairment test of its intangible assets and concluded that no impairment existed. During the three and six months ended June 30, 2016, there were no adverse changes in long-lived assets, which caused a need for an impairment analysis.

Changes in the carrying amount of goodwill are as follows (in thousands):

	Balance
Gross carrying amount at December 31, 2016	\$ 113,589
Accumulated impairment charges at December 31, 2016	(41,276)
Net carrying value of goodwill at December 31, 2016	<u>\$ 72,313</u>
Impairment charge for the quarter ended June 30, 2017	(21,137)
Net carrying value of goodwill at June 30, 2017	<u>\$ 51,176</u>

During the three months ended June 30, 2017, the Company recorded an impairment charge of \$21.1 million. The Company determined that a triggering event had occurred since the Company was unable to achieve its targeted revenue and profit forecasts during the six months ended June 30, 2017; therefore, the Company's third party valuation firm performed an interim goodwill impairment test under the provisions of ASU 2017-04 and determined that the estimated fair value of the Company's sole reporting unit was lower than the carrying value. The decline in the estimated fair value of the Company was primarily due to significantly lower revenue in 2017 than planned due to losing certain contract proposals and delays in the timing of other anticipated contract awards causing management to revise its 2017 forecast. Projected growth rates in future years remain comparable to the prior planned growth, however, projected future revenue and related profits are less than the previous plan due to significantly lower than expected revenue forecasted for 2017.

Upon completion of the interim goodwill impairment test, the Company recorded a noncash goodwill impairment charge of \$21.1 million, or 29% of the total goodwill asset. Additional sensitivity testing was completed using assumptions of only achieving 95% and 90% of the revised 2017 forecasted plan with other major assumptions including growth rates, profit margins, and discount factors remaining the same. The result of this analysis was an estimated additional goodwill impairment of between \$0.7 million and \$6.7 million and \$4.7 million and \$10.4 million, respectively. The Company also has some ability to control indirect costs during the remainder of 2017 that could mitigate any additional shortfalls in our revised 2017 revenue and profit estimates.

The goodwill impairment charges are recorded as goodwill impairment in the consolidated statements of operations. A change in any of our assumptions, including key assumptions regarding revenue growth rate, adjusted EBITDA margins and weighted average cost of capital, individually or in the aggregate, or future financial performance that is below management expectations, may result in the carrying value of this reporting unit exceeding its fair value, and could result in additional impairment to goodwill and/or amortizable intangible assets in future periods.

The primary method used to measure the impairment charge was the income method. The significant unobservable inputs used were based on company-specific information and included estimates of revenue, profit margins and discount rates. If the carrying amount of the goodwill exceeds the implied fair value of the goodwill, an impairment charge is recognized in the amount equal to that excess, not to exceed the carrying amount of the goodwill.

Additionally, the Company performed an impairment test on its long-lived intangible assets. The first step of the impairment test is to compare the undiscounted cash flows of the asset group to the carrying amount. If the results of the test determine that the undiscounted cash flows of the asset group are less than the carrying amount, then an impairment exists and further testing is required. An impairment charge was not required as of June 30, 2017 using this test.

During the three months ended June 30, 2016, the Company did not identify any triggering events related to our goodwill and therefore was not required to test goodwill for impairment.

**Note 5. Fair Value Measurements**

The Company has investments in mutual funds held in a Rabbi Trust which are classified as trading securities and are included in current assets on the accompanying condensed consolidated balance sheets. The Rabbi Trust assets are used to fund amounts the Company owes to key managerial employees under the Company's non-qualified deferred compensation plan (see Note 8). Based on the nature of the assets held, the Company uses quoted market prices in active markets for identical assets to determine fair values, which apply to Level 1 investments.

The mark to market adjustments are recorded in other income (expense), net, in the accompanying condensed consolidated statements of operations for the three and six months ended June 30, 2017 which resulted in investment income of \$0.01 million and \$0.03 million, respectively, and for the three and six months ended June 30, 2016, for a nominal gain and net investment loss of (\$0.4) million.

STG Group, Inc.

Notes to the Consolidated Financial Statements

(In thousands, except share and per share amounts)(Unaudited)

Note 6. Debt

The Company's debt as of June 30, 2017 and December 31, 2016 consists of the following:

	June 30, 2017	December 31, 2016
Term loan	\$ 74,975	\$ 77,018
Less: debt discount on term loan	(4,144)	(4,828)
Less: current portion	(70,831)	(4,496)
	<u>\$ -</u>	<u>\$ 67,694</u>

**Credit Agreement:** In connection with the consummation of the Business Combination, the Company entered into a new facility (the Credit Agreement) with a different financial lending group. The Credit Agreement provides for: (a) a term loan in an aggregate principal amount of \$81.8 million; (b) a \$15 million asset-based revolving line-of-credit; and (c) an uncommitted accordion facility to be used to fund acquisitions of up to \$90 million. Concurrent with the consummation of the Business Combination, the full amount of the term loan was drawn and there were no amounts drawn on the other two facilities. Each facility matures on November 23, 2020. The Company recorded \$6.4 million of debt issuance costs in connection with the new facility as a reduction to the carrying amount of the new term loan. These costs are amortized using the effective interest method over the life of the term loan.

The principal amount of the term loan amortizes in quarterly installments which increase after each annual period. The quarterly installments range from 0.625% to 2.500% of the original principal amount and are paid through the quarter ending September 30, 2019. The remaining unpaid principal is due on the maturity date of November 23, 2020.

At the Company's election, the interest rate per annum applicable to all the facilities is based on a fluctuating rate of interest. The interest rate in effect as of June 30, 2017 and December 31, 2016 was approximately 9.0% and 10.3%, respectively. The Borrowers may elect to use either a Base Rate or a Eurodollar Rate. The interest rate per annum for electing the Base Rate will be equal to the sum of 6.80% plus the Base Rate, which is equal to the highest of: (a) the base commercial lending rate of the Collateral Agent as publicly announced to be in effect from time to time, as adjusted by the Collateral Agent; (b) the sum of 0.50% per annum and the Federal Funds Rate (as defined in the Credit Agreement); (c) the daily one month LIBOR as published each business day in *The Wall Street Journal* for a one month period divided by a number equal to 1.00 minus the Reserve Percentage (as defined in the Credit Agreement) plus 100 basis points, as of such day and; (d) 2.00%.

The interest rate per annum for electing the Eurodollar Rate will be equal to the sum of 7.80% plus the Eurodollar Rate, which is equal to the highest of: (a) the amount calculated by dividing (x) the rate which appears on the Bloomberg Page BBAM1, or the rate which is quoted by another authorized source, two business days prior to the commencement of any interest period as the LIBOR for such an amount by (y) a number equal to 1.00 minus the Reserve Percentage (as defined in the Credit Agreement) and; (b) 1.00%.

**STG Group, Inc.**

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

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**Note 6. Debt (Continued)**

The Company is also subject to certain provisions which will require mandatory prepayments of its term loan and has agreed to certain minimums for its fixed charge coverage ratio and consolidated EBITDA and certain maximums for its senior secured leverage ratio, as defined in the Credit Agreement. As of September 30, 2016, the Company did not meet the required consolidated senior secured leverage ratio and minimum consolidated EBITDA. The Company remained in compliance with the Credit Agreement using a provision of the Credit Agreement that allowed the Company to cure (Cure Right) certain covenant non-compliance by issuances of common stock for cash and use of the proceeds to reduce the principal balance of the term loan. The Company used the proceeds to reduce the principal balance of the term loan as required to effect the Cure Right.

As of December 31, 2016, the Company did not meet the required consolidated senior secured leverage ratio and minimum consolidated EBITDA. The Credit Agreement does not allow the Company to exercise the Cure Right in consecutive fiscal quarters; therefore, on February 24, 2017, the Company entered into a limited forbearance to the Credit Agreement (the "February Forbearance Agreement") with MC Admin Co LLC and the other lenders under the Credit Agreement.

The Company then entered into a Limited Waiver (Waiver) from MC Admin Co LLC and other lenders under the Credit Agreement as of March 31, 2017, pursuant to which the lenders waived the Company's noncompliance with the Specified Financial Covenants as of December 31, 2016. Pursuant to the Waiver:

- Loans under the Credit Agreement are subject to additional interest at a rate of 2% per annum until the earliest of (x) the date on which all loans are repaid and all commitments under the Credit Agreement are terminated, (y) the date the Company delivers the financial statements and certificates for the quarter ending March 31, 2017 showing that they are not in default under the Credit Agreement or (z) the date on which default interest is otherwise due under the Credit Agreement;
- The Company must obtain lender consent prior to use of its revolving credit facility; and
- The Company could not effect a Cure Right with respect to the quarter ending March 31, 2017.

The Waiver does not apply to covenant non-compliance after December 31, 2016 or to covenants other than the Specified Financial Covenants.

As of March 31, 2017 the Company was not in compliance with the covenants related to the consolidated EBITDA and the senior secured leverage ratio. In addition, on May 18, 2017, the Company received a Default Notice from MC Admin that states the Company was in default under the Credit Agreement for the Budget Delivery Default. The Company believes this notice is incorrect, as the Company previously provided the required information to the lenders on February 7, 2017. The Default Notice stated that MC Admin was not taking action to enforce the lenders' rights under the Credit Agreement at this time, although it also provided that, as a result of the default, the lenders had no obligations under the Credit Agreement to provide any additional loans or letters of credit.

As of June 30, 2017 the Company was not in compliance with the Specified Financial Covenants.

**STG Group, Inc.**

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

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**Note 6. Debt (Continued)**

The Lender has not granted a waiver or forbearance for the Budget Delivery Default or the covenant violations as of March 31, 2017 and June 30, 2017. One of the remedies the Lender has available to it, amongst others, is the ability to accelerate repayment of the debt, which the Company would not be able to immediately repay.

The Lender's not having granted a waiver or other relief and the potential acceleration of the debt by the Lender resulted in the reclassification of the debt from a long-term liability to a current liability as of March 31, 2017 and June 30, 2017.

If the business continues to perform at the current level through the next quarter, the Company does not expect to satisfy the Specified Financial Covenants at that time, and it is likely that the Company will be in non-compliance at September 30, 2017. The Company's inability to meet the required covenant levels could have a material adverse impact to the Company, including the need for the Company to effect an additional Cure Right or obtain additional forbearance or an amendment, waiver, or other changes in the Credit Agreement. The Credit Agreement does not allow the Company to exercise the Cure Right in consecutive fiscal quarters, more than three fiscal quarters in the aggregate, or in more than two of any four fiscal quarters. The amount allowed under the Cure Right may not exceed the lesser of \$2.5 million and 20% of consolidated EBITDA. The aggregate of Cure Rights may not exceed \$5 million.

Any additional forbearance, amendment or waiver under the Credit Agreement may result in increased interest rates or premiums and more restrictive covenants and other terms less advantageous to the Company, and may require the payment of a fee for such forbearance, amendment or waiver. If the Company is unable to renegotiate the financial covenants either through a new credit agreement or through an amendment of the existing financial covenants under the current Credit Agreement, we may not be able to obtain a forbearance, waiver or effect a cure, on acceptable terms.

Even if the Lender does grant forbearance or an amendment to or waiver under the Credit Agreement, any future covenant non-compliance could give rise to an event of default thereunder.

If the Lender does not grant forbearance or a waiver of the covenant non-compliance as of March 31, 2017 and June 30, 2017, the Budget Delivery Default, or any future covenant non-compliance, the indebtedness under the Credit Agreement could be declared immediately due and payable, which could have a material adverse effect on the Company.

**Note 7. Commitments and Contingencies**

**Legal matters:** From time to time the Company may be involved in litigation in the normal course of its business. Management does not expect that the resolution of these matters would have a material adverse effect on the Company's business, operations, financial condition or cash flows.

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

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**Note 8. Deferred Compensation Plan**

The Company maintains a deferred compensation plan (the Deferred Compensation Plan) in the form of a Rabbi Trust, covering key managerial employees of the Company as determined by the Board of Directors. The Deferred Compensation Plan gives certain senior employees the ability to defer all, or a portion, of their salaries and bonuses on a pre-tax basis and invest the funds in marketable securities that can be bought and sold at the employee's discretion. The future compensation is payable upon either termination of employment or change of control. The liabilities are classified within current liabilities as of June 30, 2017 and December 31, 2016 on the condensed consolidated balance sheets. The assets held in the Rabbi Trust are comprised of mutual funds and are carried at fair value based on the quoted market prices. As of June 30, 2017 and December 31, 2016, the amount payable under the Deferred Compensation Plan was equal to the value of the assets owned by the Company. These assets total \$0.4 million and \$0.3 million as of June 30, 2017 and December 31, 2016, respectively, and are included as part of current assets in the accompanying condensed consolidated balance sheets. Additionally, the Company may make discretionary matching contributions to the Deferred Compensation Plan, which vest ratably over three years. The Company recorded contributions to the Deferred Compensation Plan of \$0.04 million and \$0.08 million, respectively, for the three and six months ended June 30, 2017. The Company recorded no contributions to the Deferred Compensation Plan for the three and six months ended June 30, 2016. The assets are available to satisfy the claims of the Company's creditors in the event of bankruptcy or insolvency of the Company. The participants in the Deferred Compensation Plan were paid a distribution of their earnings to date through the consummation of the Business Combination. This distribution totaled \$4.1 million and was paid on January 25, 2016.

**Note 9. Related Party Transactions**

A company owned by a party related to the majority stockholder of the Company is both a subcontractor to and customer of the Company on various contracts. As of June 30, 2017 there were no amounts due from this entity and at December 31, 2016, amounts due from this entity totaled \$0.01 million. The Company recorded no revenue for the three months ended June 30, 2017 and \$0.01 million of revenue for the six months ended June 30, 2017. The Company recorded revenue of \$0.03 million and \$0.04 million, respectively, for the three and six months ended June 30, 2016.

No amount was due to this entity as of June 30, 2017 and December 31, 2016 for amounts relating to work performed under subcontracts. The Company recorded no direct costs for the three and six months ended June 30, 2017 and 2016 for work performed.

On November 23, 2015, Global Strategies Group (North America) Inc. and the Company entered into a services agreement, pursuant to which the Company may retain Global Strategies Group (North America) Inc. from time to time to perform certain services: corporate development services such as assisting the Company in post-integration matters, regulatory compliance support services, financial services and financial reporting, business development and strategic services, marketing and public relations services, and human resources services. Global Strategies Group (North America) Inc. is an affiliate of both the Company and a Board member. Amounts paid and expensed under this agreement during the three and six months ended June 30, 2017 totaled \$0.1 million and \$0.3 million, respectively, and totaled \$0.1 million and \$0.3 million, respectively, for the three and six months ended June 30, 2016.

**Note 10. Stockholders' Equity**

On November 23, 2015, the Company's amended and restated certificate of incorporation authorized 110,000,000 shares of capital stock, consisting of (i) 100,000,000 shares of common stock, par value \$0.0001 per share, and (ii) 10,000,000 shares of preferred stock, par value \$0.0001 per share.

At June 30, 2017 and December 31, 2016, the Company had authorized for issuance 100,000,000 shares of \$0.0001 par value common stock, of which 16,625,849 and 16,603,449 shares were issued and outstanding, respectively, including 33,600 shares subject to the vesting of restricted stock awards as of December 31, 2016, and had authorized for issuance 10,000,000 shares of \$0.0001 par value preferred stock, of which no shares were issued and outstanding as of June 30, 2017 and December 31, 2016.

**Notes to the Consolidated Financial Statements***(In thousands, except share and per share amounts)(Unaudited)***Note 11. Stock Based Compensation**

In connection with the approval of the Business Combination, the 2015 Omnibus Incentive Plan (the Plan) was approved by stockholders to provide incentives to key employees, directors, and consultants of the Company and its subsidiaries. Awards under the Plan are generally not restricted for any specific form or structure and could include, without limitation, stock options, stock appreciation rights, dividend equivalent rights, restricted stock awards, cash-based awards, or other right or benefit under the Plan. The Plan allowed for the lesser of: (i) 1.6 million shares of common stock; or (ii) 8% of the outstanding common shares immediately following the consummation of the Business Combination as reserved and authorized for issuance under the Plan. At June 30, 2017 and December 31, 2016, there were 0.6 million and 0.9 million shares, respectively, of common stock authorized and available for issuance under the Plan.

*Stock Options*

Upon completion of the Business Combination, the Company approved initial grants of non-qualified stock option awards under the Plan to the current independent members of the Board of Directors. The stock option awards expire in ten years from the date of grant and vest over a period of one year – 20% of the options will vest 30 days following the grant date, 40% of the options will vest six months following the grant date subject to the Director's continued service and the remaining 40% of the options will vest 12 months following the grant date subject to the director's continued service. The exercise price is required to be set at not less than 100% of the fair market value of the Company's common stock on the date of grant.

In June 2016, the Company granted non-qualified stock option awards under the Plan to certain key employees of the Company. The stock option awards expire in ten years from the date of grant and vest in 20% increments over a period that ranges from the grant date to approximately 4.5 years.

In September 2016, the Company granted non-qualified stock option awards under the Plan to a key employee of the Company. The stock option awards expire in ten years from the date of grant and vest at 25% on the grant date and in 25% increments thereafter over approximately 1.5 years.

During the first quarter of 2017, the Company granted non-qualified stock option awards under the Plan to certain employees and senior management of the Company. The stock option awards expire in ten years from the date of grant and vest in 20% increments over a period that ranges from the grant date to approximately 4.0 years.

During the six months ended June 30, 2017 and 2016, the fair value of each option was estimated on the date of grant using the Black-Scholes model that uses the following weighted average assumptions:

	2017	2016
Expected dividend yield	0%	0%
Risk-free interest rate	1.9%	1.7%
Expected option term	6 years	6 years
Volatility	85.3%	88.2%
Weighted-average fair value	1.44	3.24

STG Group, Inc.

Notes to the Consolidated Financial Statements

(In thousands, except share and per share amounts)(Unaudited)

Note 11. Stock Based Compensation (Continued)

The Company calculated the expected term of the stock option awards using the “simplified method” in accordance with the *Securities and Exchange Commission Staff Accounting Bulletins No. 107 and 110* because the Company lacks historical data and is unable to make reasonable assumptions regarding the future. The Company’s assumptions with respect to stock price volatility are based on the average historical volatility of peers with similar attributes. The Company determines the risk-free interest rate by selecting the U.S. Treasury constant maturity rate.

The total compensation expense related to stock option awards under the Plan was \$0.1 million and \$0.5 million for the three and six months ended June 30, 2017, respectively, and was \$0.2 million and \$0.3 million for the three and six months ended June 30, 2016, respectively. The income tax benefit related to share-based compensation expense was approximately \$0.04 million and \$0.2 million for the three and six months ended June 30, 2017, respectively, and \$0.08 million and \$0.1 million for the three and six months ended June 30, 2016, respectively. As of June 30, 2017, \$0.8 million of total unrecognized compensation expense related to the share-based compensation Plan is expected to be recognized over a weighted-average period of 2.6 years. The total unrecognized share-based compensation expense to be recognized in future periods as of June 30, 2017 does not consider the effect of share-based awards that may be issued in future periods.

Stock option awards as of June 30, 2017, and changes during the six months ended June 30, 2017 were as follows:

	<u>Options</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (Years)</u>	<u>Aggregate Intrinsic Value</u>
Outstanding, beginning of period	679,308	\$ 4.28		
Granted	460,808	5.00		
Exercised	-	-		
Forfeited	(237,650)	5.00		
Outstanding, end of period	<u>902,466</u>	<u>4.46</u>	<u>9.26</u>	<u>\$ -</u>
Exercisable, end of period	<u>411,946</u>	<u>\$ 4.43</u>	<u>9.13</u>	<u>\$ -</u>

There was no aggregate intrinsic value for the options outstanding and exercisable at June 30, 2017, because the exercise price exceeds the underlying share price.

Restricted Stock Awards

In June 2016, the Company granted restricted stock awards under the Plan to members of the Board of Directors. The awards vest at 20% on the date of the award and in two 40% increments during the remaining annual period.

The total compensation expense related to restricted stock awards granted under the Plan was \$0.02 million and \$0.05 million, respectively, for the three and six months ended June 30, 2017 and was \$0.02 million for both the three and six months ended June 30, 2016. The income tax benefit related to the restricted stock awards was approximately \$0.01 million and \$0.02 million, respectively, for the three and six months ended June 30, 2017 and was \$0.01 million for both the three and six months ended June 30, 2016. As of June 30, 2017, there was no unrecognized compensation expense related to the restricted stock awards under the Plan.

There were no outstanding non-vested restricted awards as of June 30, 2017, and there were 22,400 shares of restricted stock that vested during the three months ended June 30, 2017. Outstanding (non-vested) restricted awards as of June 30, 2016 totaled 44,800, and 11,200 shares of restricted stock vested during the six months ended June 30, 2016. The weighted-average grant date fair value of vested and non-vested awards was \$1.99 per share.

**STG Group, Inc.**

**Notes to the Consolidated Financial Statements**

*(In thousands, except share and per share amounts)(Unaudited)*

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**Note 12. Income Taxes**

The effective income tax rate was 12.7% and 16.5%, respectively, for the three and six months ended June 30, 2017 and was 38.9% and 34.8%, respectively, for the three and six months ended June 30, 2016. The Company's effective tax rate for the three and six months ended June 30, 2017 and 2016, differs from the statutory federal rate as a result of state benefits, net of federal provision, permanent differences primarily due to goodwill impairment and changes in estimates made in the deferred taxes recorded as part of the Business Combination, which were not accounted for as measurement period adjustments.

**Note 13. Segment Information**

Segment information is not presented since all of the Company's revenue and operations are attributed to a single reportable segment. In accordance with authoritative guidance on segment reporting under the FASB, the chief operating decision maker has been identified as the President. The President reviews operating results to make decisions about allocating resources and assessing performance for the entire company.

**Note 14. Subsequent Events**

*Termination of the Merger Agreement by PSS*

On July 1, 2017, the Agreement and Plan of Merger, dated as of February 18, 2017, and amended on May 8, 2017, among STG Group, Inc. (the "Company"), PSS Holdings, Inc. ("PSS") and the other parties thereto was terminated by PSS following the expiration of the date for closing the transaction in accordance with the terms of the agreement. In connection with the termination, and pursuant to the terms of the agreement, PSS retained the \$925,000 advance payment paid to PSS by the Company on May 8, 2017.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**INTRODUCTORY STATEMENT**

The following discussion and analysis of financial condition and results of operations of the Company should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2016, and the related notes thereto, along with the related Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2016 Annual Report on Form 10-K for the year ended December, 31, 2016.

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") contains certain financial measures, in particular the presentation of EBITDA and Adjusted EBITDA, which are not presented in accordance with generally accepted accounting principles ("GAAP"). These non-GAAP financial measures are being presented because they provide readers of this MD&A with additional insight into the Company's operational performance relative to comparable prior periods presented and relative to its peer group. EBITDA and Adjusted EBITDA are key measures used by the Company to evaluate its performance. The Company does not intend for these non-GAAP financial measures to be a substitute for any GAAP financial information. Readers of this MD&A should use these non-GAAP financial measures only in conjunction with the comparable GAAP financial measures. Reconciliations of EBITDA and Adjusted EBITDA to net income, the most comparable GAAP measure, are provided in this MD&A.

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

We make forward-looking statements in this Quarterly Report on Form 10-Q. These forward-looking statements relate to outlooks or expectations for earnings, revenues, expenses or other future financial or business performance, strategies or expectations, or the impact of legal or regulatory matters on business, results of operations or financial condition. Specifically, forward-looking statements may include statements relating to:

- the future financial performance of the Company;

**Management's Discussion and Analysis**

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- expansion plans and opportunities;
- maintaining/increasing our growth rates through marketing and an effective sales force;
- maintaining our technology platforms and continuing to develop enhancements;
- maintaining cost-effectiveness of technology and operations;
- maintaining and successfully bidding for government contracts;
- changes in economic, business, competitive, technological and/or regulatory factors;
- identify and consummating acquisitions on an accretive basis; and
- other statements preceded by, followed by or that include the words “estimate,” “plan,” “project,” “forecast,” “intend,” “expect,” “anticipate,” “believe,” “seek,” “target” or similar expressions.

Other risks and uncertainties indicated in this report, as well as those disclosed in the Company's other filings with the Securities and Exchange Commission, including those discussed under “Risk Factors” in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

Should one or more of these risks or uncertainties materialize, or should any of the underlying assumptions prove incorrect, actual results may vary in material respects from those expressed or implied by these forward-looking statements. You should not place undue reliance on these forward-looking statements. These forward-looking statements are based on information available to us as of the date of this Form 10-Q and current expectations, forecasts and assumptions and involve a number of risks and uncertainties. Accordingly, forward-looking statements should not be relied upon as representing our views as of any subsequent date and we do not undertake any obligation to update forward-looking statements to reflect events or circumstances after the date they were made. These forward-looking statements involve a number of known and unknown risks and uncertainties or other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements. Some factors that could cause actual results to differ include:

- success in retaining or recruiting, or changes required in, officers, key employees or directors;
- economic weakness, either nationally, or in the local markets in which we operate;
- the size of our addressable markets and the amount of U.S. government spending on private contractors;
- adverse litigation or arbitration results;
- the potential liquidity and trading of our securities;
- risks and costs associated with regulation of corporate governance and disclosure standards (including pursuant to Section 404 of the Sarbanes-Oxley Act);
- the risk factors listed in our Annual Report on Form 10-K for the year ended December 31, 2016, under “*Risk Factors*” beginning on page 17.
- changes in economic, business, competitive, technological and/or regulatory factors; and,
- competitors in our various markets.

**OVERVIEW**

We provide specialist cyber, software and intelligence solutions to U.S. government organizations with a national security mandate. Our solutions are integral to national security-related programs run by more than 50 U.S. government agencies, including the Department of Defense, the Intelligence Community, the Department of Homeland Security, the Department of State and other government departments with national security responsibilities. Our programs are predominantly funded from base budgets and are essential to the effective day-to-day operations of our customers.

Our operational strength and track record has been established in securing highly sensitive, mission-critical national security networks, solving complex technology problems in mission-critical contexts and providing decision makers with actionable intelligence from multiple data sources.

Our primary areas of expertise include:

- Security information and event management
- Network intrusion detection and prevention
- Application vulnerability assessment
- Agile software development
- Command and control system development
- Complex application development
- Advanced collection and analysis
- Multi-intelligence exploitation and dissemination
- Multi-lingual intelligence analysis

We are SEI CMMI Maturity Level 3 Rated and hold certifications in ISO 9001:2008 and ISO/IEC 20000-1:2011. We fully integrate ISO 20000-1:2011 quality aspects into our corporate engineering methodology to ensure we deliver high-quality products and services on time and within budget.

We employ over 760 cybersecurity, software development and intelligence analysis professionals who deliver these solutions in both the continental United States and in approximately 6 overseas locations.

## STG Group, Inc.

### Management's Discussion and Analysis

The Predecessor was founded in 1986 as the Software Technology Group. Over that time, we have built strong, trusted and enduring relationships with a wide range of Federal Government customers, supporting their mission-critical operations across a very broad contract base. We have achieved a period of continuous performance of more than a decade. Our single largest contract represented 23% and 20% of total revenues for the 3 months ending June 30, 2017 and 2016, respectively. Similarly, the top 5 contracts represented 69% and 57% of total revenues for the 3 months ending June 30, 2017 and 2016, respectively.

We are currently contracted with approximately 50 U.S. Federal Government organizations, and we derive the majority of our revenue from contracts with U.S. Government agencies with a national security mission. As of June 30, 2017, we derived approximately 42% of our revenue from the Department of Defense; approximately 40% from the Department of State; approximately 18% from other Federal Civilian agencies, with most of that revenue coming from the Department of Homeland Security; and approximately 2% coming from the Intelligence Community.

### Recent Developments

#### *Termination of the Merger Agreement by PSS*

On July 1, 2017, the Agreement and Plan of Merger, dated as of February 18, 2017, and amended on May 8, 2017, among STG Group, Inc. (the "Company"), PSS Holdings, Inc. ("PSS") and the other parties thereto was terminated by PSS following the expiration of the date for closing the transaction in accordance with the terms of the agreement. In connection with the termination, and pursuant to the terms of the agreement, PSS retained the \$925,000 advance payment paid to PSS by the Company on May 8, 2017.

### Results of Operations (Unaudited)

#### Three Months Ended June 30, 2017 Compared to Three Months Ended June 30, 2016

#### *Selected Financial Information*

The table below summarizes the Company's second quarter of 2017 and 2016 revenues and income from operations.

	Three Months Ended June 30, 2017	(Decrease)/Increase		Three Months Ended June 30, 2016
		\$	%	
<i>(in millions, except percentages)</i>				
Contract revenue	\$ 33.8	\$ (7.1)	(17)%	\$ 40.9
Direct expenses	23.0	(4.7)	(17)%	27.7
Gross profit	10.8	(2.4)	(18)%	13.2
Indirect and selling expenses	14.2	1.0	8%	13.2
Impairment of goodwill	21.1	21.1	*	0.0
Operating loss	(24.5)	(24.5)	*	0.0
Other (expense) income, net	0.0	0.0	*	0.0
Interest expense	2.5	0.4	19%	2.1
Loss before income taxes	(27.0)	(24.9)	(1,186)%	(2.1)
Income tax benefit	3.4	2.6	325%	0.8
Net loss	\$ (23.6)	\$ (22.3)	(1,715)%	\$ (1.3)

**Management's Discussion and Analysis**


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**Contract Revenue**

Revenue for the second quarter of 2017 decreased by \$7.1 million, or 17% compared to the same period in 2016. The decrease in revenue is due to the expiration of contracts with the Army, the Department of Defense, the Department of Homeland Security, the Department of Housing and Urban Development ("HUD") and a subcontract to perform work with the National Oceanic and Atmospheric Administration ("NOAA").

The table below summarizes the Company's revenue by customer for the second quarter of 2017 and 2016.

Revenue by customer	Three months ended June 30,			
	2017		2016	
	<i>(in thousands, except percentages)</i>			
Department of Defense	\$ 14,481	43%	\$ 17,991	44%
Department of State	13,353	40%	14,665	36%
Department of Homeland Security	2,394	7%	2,482	6%
Intelligence Community	987	3%	923	2%
Other Federal Civilian	2,542	7%	4,857	12%
	<u>\$ 33,757</u>		<u>\$ 40,918</u>	

The Department of Defense continues to be our largest customer with 43% and 44% of the revenue generated from this customer during the second quarter of both financial year 2017 and 2016, respectively. Revenue by customer decreased across all but the Intelligence Community customers in 2017 compared to the same period in 2016.

Time-and-materials contract revenue increased by \$2.0 million in the second quarter of 2017 versus the second quarter of 2016. The increase in time and materials contracts was driven by consolidation and conversion of several fixed price and cost plus fixed fee contracts to time and materials contract type. Fixed price contract revenue decreased by \$2.9 million primarily due to the conversions just mentioned and the completion of subcontract work with NOAA. The \$6.2 million reduction in Cost Plus Fixed Fee revenues was due to the expiration of contracts with the Army and HUD and contract consolidations and conversions.

The table below summarizes the second quarter of 2017 and second quarter of 2016 revenue by contract billing type.

Revenue by Contract Type	Three months ended June 30,			
	2017		2016	
	<i>(in thousands, except percentages)</i>			
T&M	\$ 16,022	48%	\$ 14,026	34%
Fixed price	7,927	23%	10,855	27%
CPEF	9,808	29%	16,037	39%
	<u>\$ 33,757</u>		<u>\$ 40,918</u>	

Prime contract revenue decreased by \$6.0 million in the second quarter of 2017 compared to second quarter of 2016. The decrease was attributable to the expiration and lower tasking on Army, HUD and Department of State contracts. The decrease in Subcontract revenue by \$1.1 million is largely due to the expiration of subcontract work performed at NOAA. The Company continues to look to increase its presence as a prime contractor on larger, more complex programs where it delivers services to customers by deploying its own staff and expertise, and by managing the efforts of other contractors.

The table below summarizes the Company's second quarter of 2017 and 2016 revenue by prime and subcontract type.

Revenue - Prime and Subcontract	Three months ended June 30,			
	2017		2016	
	<i>(in thousands, except percentages)</i>			
Prime	\$ 29,724	88%	\$ 35,742	87%
Subcontract	4,033	12%	5,176	13%
	<u>\$ 33,757</u>		<u>\$ 40,918</u>	

**Management's Discussion and Analysis**

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***Direct Expenses and Gross Profit***

Direct expenses consist of direct labor, subcontractors and consultants, and other direct costs. In the quarter ended June 30, 2017, direct expenses decreased by 17%, or \$4.7 million over the same period a year ago. This decrease in direct expenses is mainly a result of a reduction in Company employees and subcontractors as a result of the expiration of contracts with the Army, Department of Defense, Department of Homeland Security, HUD and a subcontract to perform work at NOAA.

Gross profit for the three months ended June 30, 2017 was lower by \$2.4 million, or 18% compared to the three months ended June 30, 2016. This decrease in gross profit is due to the decrease in revenue. Gross profit margins for the second quarter of 2017 and 2016 were 32%.

***Indirect and Selling Expenses***

Indirect and selling expenses increased \$1.0 million or 8% for the three months ended June 30, 2017 compared to the same period a year ago. The net increase in the indirect and selling expenses were due primarily to a \$0.9 million, or 13%, net decrease in fringe benefits and overhead related expenses for the three months ended June 30, 2017 compared to the three months ending June 30, 2016. The decreases in fringe benefit expenses were due to a reduction in the Company's total labor costs in the second quarter 2017 when compared to the second quarter 2016. The net decrease in overhead expense is due to lower severance benefits in the second quarter 2017 when compared to the second quarter 2016. General and administrative expenses increased by \$0.5 million, or 9%, for the three months ended June 30, 2017 when compared to the same period ending June 30, 2016 primarily due to increases in legal expenses in the second quarter 2017. There was also a \$1.4 million increase in acquisition related legal and other fees during the second quarter 2017 compared to the second quarter 2016.

***Impairment of Goodwill***

The Company recorded a goodwill impairment charge of \$21.1 million in the three month period ended June 30, 2017. The Company's third party valuation firm performed an interim goodwill impairment test and determined that the estimated fair value of the Company's sole reporting unit was lower than the carrying value. The decline in the estimated fair value of the Company was primarily due to significantly lower revenue in 2017 than planned base upon a revised forecast. Growth rates in future years remain comparable to the prior planned growth; however projected future revenue and related profits are less than the previous plan due to significantly lower 2017 revenue.

***Operating Income (Loss)***

The second quarter 2017 operating loss was (\$24.5) million compared to \$0 in the second quarter of 2016, a decrease of (\$24.5) million. The operating loss was primarily due to the goodwill impairment charge of \$21.1 million as well as lower revenue and gross profit from contracts and higher indirect and selling expenses as discussed under the heading "Indirect and Selling Expenses" above.

***Other Income (Expense)***

There were no material other income (expense) for the quarter ended June 30, 2017 and June 30, 2016.

***Interest Expense***

Interest expense was \$2.5 million and \$2.1 million for the quarters ended June 30, 2017 and 2016, respectively. Interest expense for 2016 and 2017 reflects the Company's new level of debt following the consummation of the Business Combination. See "Secured Credit Facilities" in the Liquidity and Capital Resources section of this MD&A for further discussion.

***Tax Benefit***

The tax benefit was \$3.4 million for the quarter ended June 30, 2017 compared to \$0.8 million for the second quarter of 2016. The increase in deferred tax benefit of \$2.6 million is primarily due to the operating loss offset by non-deductible goodwill impairment of \$21.1 million during the quarter ended June 30, 2017. The deferred tax benefit in 2016 was primarily due to the future benefit related to the capitalization and amortization (for tax purposes) of start-up costs related to the Business Combination.

**STG Group, Inc.****Management's Discussion and Analysis**

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*Net Loss*

Net loss was (\$23.6) million for the quarter ended June 30, 2017 compared to net loss of (\$1.3) million for the quarter ended June 30, 2016. The increase in net loss of \$22.3 million was primarily due to the goodwill impairment charge of \$21.1 million as well as lower profit on lower recorded revenue and an increase in indirect expenses as the Company expands business development capabilities.

**Results of Operations (Unaudited)****Six Months Ended June 30, 2017 Compared to Six Months Ended June 30, 2016***Selected Financial Information*

The table below summarizes the Company's first six months of 2017 and 2016 revenues and income from operations.

	Six Months	(Decrease)/Increase		Six Months
	Ended			Ended
	June 30,			June 30,
	2017	\$	%	2016
<i>(in millions, except percentages)</i>				
Contract revenue	\$ 69.5	\$ (12.0)	(15)%	\$ 81.5
Direct expenses	46.7	(8.4)	(15)%	55.1
Gross profit	22.8	(3.6)	(14)%	26.4
Indirect and selling expenses	29.1	3.1	12%	26.0
Impairment of goodwill	21.1	21.1	*	0.0
Operating (loss) income	(27.4)	(27.8)	(6,950)%	0.4
Other (expense) income, net	0.0	(0.4)	*	(0.4)
Interest expense	4.9	0.6	14%	4.3
Loss before income taxes	(32.3)	(28.0)	(651)%	(4.3)
Income tax benefit	5.3	3.8	253%	1.5
Net loss	\$ (27.0)	\$ (24.2)	(864)%	\$ (2.8)

**Management's Discussion and Analysis**


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**Contract Revenue**

Revenue for the six months ended June 30, 2017 decreased by \$12.0 million, or 15% compared to the same period in 2016. The decrease in revenue is due to the expiration of contracts with the Army, the Department of Defense, the Department of Homeland Security and the Department of Housing and Urban Development ("HUD") and Subcontract work performed at NOAA.

The table below summarizes the Company's revenue by customer for the six months ended June 30, 2017 and 2016.

Revenue by customer	Six months ended June 30,			
	2017		2016	
	<i>(in thousands, except percentages)</i>			
Department of Defense	\$ 29,438	42%	\$ 35,430	43%
Department of State	27,753	40%	29,463	36%
Department of Homeland Security	4,730	7%	5,600	7%
Intelligence Community	1,784	3%	1,958	3%
Other Federal Civilian	5,830	8%	9,073	11%
	<u>\$ 69,535</u>		<u>\$ 81,524</u>	

The Department of Defense continues to be our largest customer with 42% and 43% of the revenue generated from this customer during the first six months ended June 30, 2017 and 2016, respectively. Revenue by customer decreased across all customers in 2017 compared to the same period in 2016.

Time-and-materials contract revenue increased by \$4.6 million in the first six months of 2017 versus the same six months of 2016. The increase in time and materials contracts was driven by consolidation and conversion of several fixed price and cost plus fixed fee contracts to time and materials contracts. Fixed price contract revenue decreased by \$4.4 million primarily due to the conversions and the completion of subcontract work with NOAA. The \$12.1 million reduction in Cost Plus Fixed Fee revenues was due to the expiration of contracts with the Army, Department of Defense and HUD.

The table below summarizes the six months ended June 30, 2017 and six months ended June 30, 2016 revenue by contract billing type.

Revenue by Contract Type	Six months ended June 30,			
	2017		2016	
	<i>(in thousands, except percentages)</i>			
T&M	\$ 32,761	47%	\$ 28,194	34%
Fixed price	17,409	25%	21,841	27%
CPFF	19,365	28%	31,489	39%
	<u>\$ 69,535</u>		<u>\$ 81,524</u>	

Prime contract revenue decreased by \$9.9 million for the six months ended June 30, 2017 compared to the same period in 2016. Subcontract contract revenue decreased by \$2.1 million for the six months ended June 30, 2017 compared to the six months ended June 30, 2016. The decrease in Prime and Subcontract revenue was attributable to the expiration of Army, Department of Homeland Security and HUD contracts. The Company continues to look to increase its presence as a prime contractor on larger, more complex programs where it delivers services to customers by deploying its own staff and expertise, and by managing the efforts of other contractors.

The table below summarizes the Company's six months ended June 30, 2017 and 2016 revenue by prime and subcontract type.

Revenue - Prime and Subcontract	Six months ended June 30,			
	2017		2016	
	<i>(in thousands, except percentages)</i>			
Prime	\$ 61,004	88%	\$ 70,890	87%
Subcontract	8,531	12%	10,634	13%
	<u>\$ 69,535</u>		<u>\$ 81,524</u>	

**Management's Discussion and Analysis**

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*Direct Expenses and Gross Profit*

Direct expenses consist of direct labor, subcontractors and consultants, and other direct costs. In the six months ended June 30, 2017, direct expenses decreased by 15%, or \$8.4 million over the same period a year ago. This decrease in direct expenses is mainly a result of a reduction in Company employees and subcontractors as a result of the expiration of Army, Department of Defense, Department of Homeland Security and HUD contracts and the end of the Subcontract work performed at NOAA.

Gross profit for the six months ended June 30, 2017 was lower by \$3.6 million, or 14% compared to the six months ended June 30, 2016. This decrease in gross profit is due to the decrease in revenue. Gross profit margins for the six months ended June 30, 2017 were 33% compared to 32% for the same period of 2016.

*Indirect and Selling Expenses*

Indirect and selling expenses increased \$3.1 million or 12% for the six months ended June 30, 2017 compared to the same period a year ago. The net increase in indirect and selling expenses was comprised of \$1.6 million or 13.7% net decrease in fringe benefits expense for the six months ended June 30, 2017 compared to the same period a year ago. The decrease in fringe benefit expense was the result of reductions in the overall contract workforce. There was a \$1.6 million, or 19%, net increase in general and administrative expenses for the six months ended June 30, 2017 compared to the same period a year ago. The increases in general and administrative expenses were primarily related to an increase in full time general and administrative labor, indirect consulting and temporary labor. There was also a \$3.1 million increase in stock compensation expense and acquisition related legal and other fees incurred for the six months ended June 30, 2017 compared with the six months ended June 30, 2016.

*Impairment of Goodwill*

The Company recorded an impairment charge of \$21.1 million in the six month period ended June 30, 2017. The Company's third party valuation firm performed an interim goodwill impairment test and determined that the estimated fair value of the Company's sole reporting unit was lower than the carrying value. The decline in the estimated fair value of the Company was primarily due to significantly lower revenue in 2017 than planned based upon a revised forecast. Growth rates in future years remain comparable to the prior planned growth; however projected future revenue and related profits are less than the previous plan due to significantly lower 2017 revenue.

*Operating Income (Loss)*

Operating loss was (\$27.4) million for the six months ended June 30, 2017 compared to operating income of \$0.4 million in the six months ended June 30, 2016, a decrease of (\$27.8) million. The reduced operating income was primarily due to the goodwill impairment charge of \$21.1 and lower revenue and gross profit from contracts as well as higher indirect and selling expenses as discussed under the heading "Indirect and Selling Expenses" above.

*Other Income (Expense)*

There were no material other income (expense) for the six months ended June 30, 2017 compared to (\$0.4) million for the six months ended June 30, 2016. The difference of \$0.4 million is principally comprised of investment losses from the Rabbi Trust Market fluctuations recorded during the first quarter 2016.

*Interest Expense*

Interest expense was \$4.9 million and \$4.3 million for the six months ended June 30, 2017 and 2016, respectively. Interest expense for 2016 and 2017 reflects the Company's new level of debt following the consummation of the Business Combination. See "Secured Credit Facilities" in the Liquidity and Capital Resources section of this MD&A for further discussion.

*Tax Benefit*

The tax benefit was \$5.3 million for the six months ended June 30, 2017 compared to \$1.5 million for the same period of 2016. The increase in deferred tax benefit of \$3.8 million is primarily due to the operating loss, offset by non-deductible goodwill impairment of \$21.1 million in the six months ended June 30, 2017. The deferred tax benefit in 2016 was primarily due to the future benefit related to the capitalization and amortization (for tax purposes) of start-up costs related to the Business Combination.

## STG Group, Inc.

### Management's Discussion and Analysis

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#### Net Loss

Net loss was (\$27.0) million for the six months ended June 30, 2017 compared to a net loss of (\$2.8) million for the six months ended June 30, 2016. The increase in net loss of \$24.2 million was primarily due to the goodwill impairment charge recorded of \$21.1 and lower profit on lower recorded revenue and an increase in indirect expenses as the Company expands business development capabilities.

The Company defines EBITDA as net income (loss) before interest expense, provision (benefit) for income taxes, depreciation and amortization and (gain)/loss on disposal of property, plant and equipment.

The Company defines Adjusted EBITDA as EBITDA, excluding the impact of operational restructuring charges and non-cash or non-operational losses or gains, including long-lived asset impairment charges, formal cost reduction plans, excess and unutilized accruals, transactional legal fees, other professional fees and retention employee bonuses.

Management believes that Adjusted EBITDA provides a clear picture of our operating results by eliminating expenses and income that are not reflective of the underlying business performance. We use this metric to facilitate a comparison of operating performance on a consistent basis from period to period and to analyze the factors and trends affecting its core business areas. Our internal plans, budgets and forecasts use Adjusted EBITDA as a key metric and the Company uses this measure to evaluate its operating performance and core business operating performance and to determine the level of incentive compensation paid to its employees. Adjusted EBITDA is not an item recognized by the generally accepted accounting principles in the United States of America, or U.S. GAAP, and should not be considered as an alternative to net income, operating income, or any other indicator of a company's operating performance required by U.S. GAAP. Our definition of Adjusted EBITDA used here may not be comparable to the definition of Adjusted EBITDA used by other companies. A reconciliation of net loss to Adjusted EBITDA is as follows:

Set forth below is a reconciliation of Adjusted EBITDA to net loss (unaudited)

	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Net loss	\$ (27.0)	\$ (2.8)
Income tax benefit	(5.3)	(1.5)
Interest expense	4.2	3.6
Amortization of loan issuance cost	0.7	0.7
Depreciation and amortization	0.2	0.3
Amortization of intangibles and goodwill impairment	24.4	3.5
EBITDA	<u>\$ (2.8)</u>	<u>\$ 3.8</u>
Adjustments to EBITDA		
Integration and other restructuring costs (1)	\$ 0.9	\$ 2.0
Nonrecurring expenses- advisory, legal, and professional fees (2)	1.3	0.6
Transaction related expenses (3)	3.1	0.2
Share-based compensation (4)	0.6	0.3
Adjusted EBITDA	<u>\$ 3.1</u>	<u>\$ 6.9</u>

- (1) Integration and other restructuring costs include development of incentive compensation plans, executive recruiting fees, branding, communication plans, and severance related to reductions in force.
- (2) Expenses incurred by the Company as a result of transitioning from a privately owned entity to a public company. These expenses include increased legal and accounting costs, investor relations, and marketing expenses.
- (3) Transaction-related expenses primarily consist of professional service fees related to the PSS Acquisition and the Business Combination.
- (4) Represents non-cash share based compensation expense for awards under the Company's 2015 Omnibus Incentive Plan.

## Liquidity and Capital Resources

### Background

For quarter ended March 2016 and in prior years, the Company had not been leveraged other than its revolving credit facility which in the past had been used to provide working capital, mobilize new project wins, and cover abnormal fluctuations in the timing of cash receipts and payments.

On November 23, 2015, the Company, together with STG Group, STG, Inc., and Access Systems entered into a Credit Agreement (the "Credit Agreement") with the lenders party thereto from time to time, MC Admin Co LLC (the "Lender"), as administrative agent, PNC Bank, National Association, as collateral agent (the "Collateral Agent"), and MC Admin Co LLC, as lead arranger. The Company served as the initial borrower of the term loans under the Credit Agreement, and STG, Inc. and Access Systems (collectively, the "Borrowers") each immediately assumed all obligations of the Company under the Credit Agreement as if they had originally incurred them as borrowers. The Company and STG Group have each guaranteed Borrowers' obligations under the Credit Agreement.

The Revolving Loan and the Term Loan both mature on November 23, 2020.

As of June 30, 2017, the Company had \$1.4 million of available cash. Because the Company did not meet the required consolidated senior secured leverage ratio and minimum consolidated EBITDA required in the Credit Agreement as of June 30, 2017 the \$15 million of borrowings under the revolving credit facility are only available subject to lender consent, and the \$90 million uncommitted accordion facility is not available.

**Management's Discussion and Analysis**

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**Going Concern Consideration:** The condensed consolidated financial statements included in this Form 10-Q have been prepared using the going concern basis of accounting, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

The Company was not in compliance with its financial covenants related to the consolidated EBITDA, and the senior secured leverage ratio under the Credit Agreement at September 30, 2016, December 31, 2016, March 31, 2017 and June 30, 2017, and was also not in compliance with its financial covenant related to the fixed charge coverage ratio under the Credit Agreement (collectively with the consolidated EBITDA and senior secured leverage ratio covenants, the "Specified Financial Covenants") at June 30, 2017. At September 30, 2016, the non-compliance was cured by raising equity from stockholders ("Equity Cure") as was allowed by the Credit Agreement. At December 31, 2016 the Company received a forbearance which expired on March 31, 2017. The Company then entered into a Limited Waiver ("the Waiver") from MC Admin Co LLC and other lenders under the Credit Agreement as of March 31, 2017, pursuant to which the lenders waived the Company's noncompliance with the covenants related to the consolidated EBITDA and the senior secured leverage ratio as of December 31, 2016. Pursuant to the Waiver:

- Loans under the Credit Agreement are subject to additional interest at a rate of 2% per annum until the earliest of (x) the date on which all loans are repaid and all commitments under the Credit Agreement are terminated, (y) the date the Company delivers the financial statements and certificates for the quarter ending March 31, 2017 showing that they are not in default under the Credit Agreement or (z) the date on which default interest is otherwise due under the Credit Agreement;
- The Company must obtain lender consent prior to use of its revolving credit facility; and
- The Company could not effect a Cure Right with respect to the quarter ending March 31, 2017.

The Company was not in compliance with the covenants related to the consolidated EBITDA and the senior secured leverage ratio for the quarter ended March 31, 2017 and was not in compliance with the Specified Financial Covenants for the quarter ended June 30, 2017. The Lender has not granted a waiver for the covenant violations as of March 31, 2017 and June 30, 2017. Without a waiver or other relief under the Credit Agreement, one of the remedies the Lender has available to it, amongst others, is the ability to accelerate repayment of the debt, which the Company would not be able to immediately repay

If the business continues to perform at the current level through the next quarter, the Company does not expect to satisfy the Specified Financial Covenants at that time, and it is likely that the Company will be in non-compliance at September 30, 2017. The Company's inability to meet the required covenant levels could have a material adverse impact to the Company, including the need for the Company to effect an additional Cure Right or obtain additional forbearance or an amendment, waiver, or other changes in the Credit Agreement. The Credit Agreement does not allow the Company to exercise the Cure Right in consecutive fiscal quarters, more than three fiscal quarters in the aggregate, or in more than two of any four fiscal quarters. The amount allowed under the Cure Right may not exceed the lesser of \$2.5 million and 20% of consolidated EBITDA. The aggregate of Cure Rights may not exceed \$5 million.

**Management's Discussion and Analysis**

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The Lender's not having granted a waiver or other relief from the Lender and the potential acceleration of the debt by the Lender resulted in the reclassification of debt from a long-term liability to a current liability as of March 31, 2017 and June 30, 2017.

Even if the Lender does grant forbearance or an amendment to or waiver under the Credit Agreement, any future covenant non-compliance could give rise to an event of default thereunder.

In addition, on May 18, 2017, the Company received a notice of default (the "Default Notice") from MC Admin Co LLC ("MC Admin") that states the Company was in default under the Credit Agreement for failing to deliver an annual budget to the lenders on January 15, 2017 as required by the Credit Agreement (the "Budget Delivery Default"). The Company believes this notice is incorrect, as the Company previously provided the required information to the lenders on February 7, 2017. The Default Notice stated that MC Admin was not taking action to enforce the lenders' rights under the Credit Agreement at this time, although it also provided that, as a result of the default, the lenders had no obligations under the Credit Agreement to provide any additional loans or letters of credit. The Lender has not granted a waiver or other relief from the Budget Delivery Default.

The potential acceleration of the loan repayment due to the Lender not providing a waiver required the Company to evaluate whether there is substantial doubt regarding the Company's ability to continue as a going concern.

Management's Plan to alleviate this condition is as follows:

1. Identify, qualify, and win new business to increase revenue and profits,
2. Raise additional equity which would be used to reduce the loan, or
3. Renegotiate the current Credit Agreement to obtain relief from the existing financial covenants and other terms.

As discussed in our Form 10-Q for the quarter ended March 31, 2017, based on the facts that existed as of December 31, 2016, management determined that it was probable that the condition giving rise to the going concern evaluation had been sufficiently alleviated as of December 31, 2016. However, the Lender has not currently granted a waiver or other relief for the Budget Delivery Default or the financial covenant violations as of March 31, 2017 or June 30, 2017. Consequently, management has changed our assessment regarding the potential acceleration of the loan repayment made as of December 31, 2016. As the Lender has not currently granted a waiver or other form of relief for the financial covenant violations as of June 30, 2017, and as disclosed above, sent us a default letter on May 18, 2017, there exists substantial doubt about our ability to continue as a going concern, in the event the Lender exercises its rights to accelerate the repayment of the loan.

**Management's Discussion and Analysis**

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**Indebtedness**

In connection with the consummation of the Business Combination, all indebtedness under STG Group's prior credit facility was repaid in full and the agreement was terminated. The Company replaced the prior credit facility and entered into a new facility (the Credit Agreement) with the Lender.

The Credit Agreement provides for:

- (a) a term loan in an aggregate principal amount of \$81.75 million
- (b) a \$15 million asset-based revolving line-of-credit
- (c) an uncommitted accordion facility to be used to fund acquisitions of up to \$90 million.

Concurrent with the consummation of the Business Combination, the full amount of the term loan was drawn and there were no amounts drawn on the other two facilities. Each facility matures on November 23, 2020. The Company recorded \$6.2 million of debt issuance costs in connection with the new facility as a reduction to the carrying amount of the new term loan. These costs will be amortized using the effective interest method over the life of the term loan.

The principal amount of the term loan amortizes in quarterly installments which increase after each annual period. The quarterly installments range from 0.625% to 2.500% of the original principal amount and are paid through the quarter ending September 30, 2019. The remaining unpaid principal is due on the maturity date of November 23, 2020.

At the Company's election, the interest rate per annum applicable to all the facilities is based on a fluctuating rate of interest. The interest rate in effect as of June 30, 2017 was 8.95%. The Borrowers may elect to use either a Base Rate or a Eurodollar Rate. The interest rate per annum for electing the Base Rate will be equal to the sum of 6.80% plus the Base Rate, which is equal to the highest of: (a) the base commercial lending rate of the Collateral Agent as publicly announced to be in effect from time to time, as adjusted by the Collateral Agent; (b) the sum of 0.50% per annum and the Federal Funds Rate (as defined in the Credit Agreement); (c) the daily one month LIBOR rate as published each business day in the Wall Street Journal for a one month period divided by a number equal to 1.00 minus the Reserve Percentage (as defined in the Credit Agreement) plus 100 basis points, as of such day and; (d) 2.00%.

The interest rate per annum for electing the Eurodollar Rate will be equal to the sum of 7.80% plus the Eurodollar Rate, which is equal to the highest of: (a) the amount calculated by dividing (x) the rate which appears on the Bloomberg Page BBAM1, or the rate which is quoted by another authorized source, two business days prior to the commencement of any interest period as the LIBOR for such an amount by (y) a number equal to 1.00 minus the Reserve Percentage (as defined in the Credit Agreement) and; (b) 1.00%.

Advances under the revolving line-of-credit are limited by a borrowing base which may not exceed the lesser of (x) the difference between \$15,000,000 and amounts outstanding under letters of credit issued pursuant to the Credit Agreement; and (y) an amount equal to the sum of: (i) up to 85% of certain accounts receivable of the Company plus (ii) up to 100% of unrestricted cash on deposit in the Company's accounts with the Collateral Agent, minus (iii) amounts outstanding under letters of credit issued pursuant to the Credit Agreement, minus (iv) reserves established by the Collateral Agent from time to time in its reasonable credit judgment exercised in good faith.

The Company is also subject to certain provisions which will require mandatory prepayments of its term loan and has agreed to certain minimums for its fixed charge coverage ratio and consolidated EBITDA and certain maximums for its senior secured leverage ratio, as defined in the Credit Agreement.

**Management's Discussion and Analysis**

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**Debt and Covenant Compliance**

As of September 30, 2016, the Company did not meet the required consolidated senior secured leverage ratio and minimum consolidated EBITDA under the Credit Agreement. The Company remained in compliance with the Credit Agreement using a provision of the Credit Agreement that allowed us to cure (the "Cure Right") certain covenant non-compliance by issuances of Common Stock for cash and use of the proceeds to reduce the principal balance of the term loan.

On November 14, 2016, we entered into Common Stock Purchase Agreements with Simon S. Lee Management Trust, for which Simon Lee, our Chairman, is Trustee, and Phillip E. Lacombe, our President and Chief Operating Officer (collectively, the "Investors") that provided for the sale to the Investors of 462,778 shares of Common Stock at a purchase price of \$3.60 per share, an aggregate of approximately \$1.7 million. We used the proceeds to reduce the principal balance of the term loan as required to effect the Cure Right.

The Credit Agreement does not allow the Company to exercise the Cure Right in consecutive fiscal quarters, more than three fiscal quarters in the aggregate, or in more than two of any four fiscal quarters. The amount allowed under the Cure Right may not exceed \$2.5 million and 20% of consolidated EBITDA. The aggregate Cure Rights may not exceed \$5 million.

As of December 31, 2016, the Company did not meet the required consolidated senior secured leverage ratio and minimum consolidated EBITDA required in the Credit Agreement. The Company was in compliance with all other financial covenants.

On February 24, 2017, we entered into a Limited Forbearance to Credit Agreement (the "February Forbearance Agreement") with MC Admin Co LLC and other lenders relating to the Credit Agreement.

The Company then entered into a Limited Waiver ("the Waiver") from MC Admin Co LLC and other lenders under the Credit Agreement as of March 31, 2017, pursuant to which the lenders waived the Company's noncompliance with the Specified Financial Covenants as of December 31, 2016. Pursuant to the Waiver:

- Loans under the Credit Agreement are subject to additional interest at a rate of 2% per annum until the earliest of (x) the date on which all loans are repaid and all commitments under the Credit Agreement are terminated, (y) the date we deliver the financial statements and certificates for the quarter ending March 31, 2017 showing that we are not in default under the Credit Agreement or (z) the date on which default interest is otherwise due under the Credit Agreement;
- We must obtain lender consent prior to use of our revolving credit facility; and
- We could not effect a Cure Right in respect of the quarter ending March 31, 2017.

The Waiver does not apply to covenant non-compliance after December 31, 2016 or to covenants other than the Specified Financial Covenants.

As of March 31, 2017 the Company was not in compliance with the covenants related to the consolidated EBITDA and the senior secured leverage ratio. In addition, on May 18, 2017, the Company received the Default Notice from MC Admin that states the Company was in default under the Credit Agreement for the Budget Delivery Default. The Company believes this notice is incorrect, as the Company previously provided the required information to the lenders on February 7, 2017. The Default Notice stated that MC Admin was not taking action to enforce the lenders' rights under the Credit Agreement at this time, although it also provided that, as a result of the default, the lenders had no obligations under the Credit Agreement to provide any additional loans or letters of credit.

As of June 30, 2017 the Company was not in compliance with the Specified Financial Covenants.

**Management's Discussion and Analysis**

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The Lender has not granted a waiver or forbearance for the Budget Delivery Default or the covenant violations as of March 31, 2017 and June 30, 2017. One of the remedies the Lender has available to it, amongst others, is the ability to accelerate repayment of the debt, which the Company would not be able to immediately repay.

The Lender's not having granted a waiver or other relief from the Lender and the potential acceleration of the debt by the Lender resulted in the reclassification of the debt from a long-term liability to a current liability as of March 31, 2017 and June 30, 2017.

If our business continues to perform at the current level through the next quarter, we do not expect to satisfy the Specified Financial Covenants at that time, and it is likely that we will be in non-compliance at September 30, 2017. Our inability to meet the required covenant levels could have a material adverse impact on us, including the need for us to effect an additional Cure Right or obtain additional forbearance or an amendment, waiver, or other changes in the Credit Agreement. The Credit Agreement does not allow the Company to exercise the Cure Right in consecutive fiscal quarters, more than three fiscal quarters in the aggregate, or in more than two of any four fiscal quarters. The amount allowed under the Cure Right may not exceed the lesser of \$2.5 million and 20% of consolidated EBITDA. The aggregate of Cure Rights may not exceed \$5 million.

Any additional forbearance, amendment or waiver under the Credit Agreement may result in increased interest rates or premiums and more restrictive covenants and other terms less advantageous to us, and may require the payment of a fee for such forbearance, amendment or waiver. If the Company is unable to renegotiate the financial covenants either through a new credit agreement or through an amendment of the existing financial covenants under our current Credit Agreement, we may not be able to obtain a forbearance, waiver or effect a cure, on terms acceptable to us.

Even if the Lender does grant forbearance or an amendment to or waiver under the Credit Agreement, any future covenant non-compliance could give rise to an event of default thereunder.

If the Lender does not grant forbearance or a waiver of our covenant non-compliance as of March 31, 2017 and June 30, 2017, the Budget Delivery Default, or any future covenant non-compliance, the indebtedness under the Credit Agreement could be declared immediately due and payable, which could have a material adverse effect on the Company.

## Management's Discussion and Analysis

## Cash Flows for the Six Months Ended June 30, 2017 and the Six Months Ended June 30, 2016

<i>(in millions)</i>	Six Months Ended		
	June 30, 2017	Variance	June 30, 2016
Cash used in operating activities	\$ (4.2)	\$ (1.0)	\$ (3.2)
Cash (used in) provided by investing activities	(0.2)	(4.1)	3.9
Cash used in financing activities	(2.0)	(1.0)	(1.0)
Net decrease in cash and cash equivalents	(6.4)	(6.1)	(0.3)
Cash and cash equivalents at beginning of period	7.8	(0.7)	8.5
Cash and cash equivalents at end of period	\$ 1.4	\$ (6.8)	\$ 8.2
Depreciation and amortization	0.2	(0.1)	0.3
Capital expenditures	0.1	0.1	0.0
Cash paid for interest	4.2	0.3	3.6
Cash paid for taxes	0.0	(0.6)	0.6
Change in investments held in Rabbi Trust	0.0	0.4	(0.4)
Change in deferred compensation plan	0.0	(0.4)	0.4

**Cash used in operating activities**

Operating cash flows are primarily affected by the Company's ability to invoice and collect from its clients in a timely manner, its ability to manage its vendor payments, the overall profitability of its contracts and its cash interest expense. Customers are mostly billed monthly after services are rendered.

For the six months ended June 30, 2017 cash used in operating activities was (\$4.2) million. The cash used in operating activities was significantly impacted by a net loss of (\$32.3) million offset by non-cash charges including share-based compensation, depreciation and amortization of intangible assets totaling \$4.7 million and an impairment of goodwill charge of \$21.1 million.

For the six months ended June 30, 2016 (successor), cash used in operating activities was (\$3.2) million. The cash used in operating activities was significantly impacted by a net loss of (\$2.8) million and a distribution of (\$3.9) million from the Rabbi Trust triggered by the Business Combination. These were offset by increases of (i) \$3.2 million of adjustments for non-cash changes in deferred taxes, deferred rent, amortization of deferred financing fees, depreciation and amortization of property and equipment, amortization of intangible assets, and stock-based compensation and (ii) a net increase in cash of \$3.8 million due to changes in contract receivables, prepaid expenses, and billings in excess of revenue. The foregoing were partially offset by \$3.4 million of payments for accounts payable and accrued expenses along with accrued payroll and payroll related liabilities.

For the six months ended June 30, 2017 the Company had cash collections of \$69.3 million, or 100% of revenue recognized in the period. For the six months ended June 30, 2016 the Company had cash collections of \$76.7 million, or 94% of revenue recognized in the period. The higher percentage of collections for the six months ended June 30, 2017 was due to lagging receivables from 2016 which were collected during this period.

The Company computes accounts receivable days sales outstanding ("DSO") based on trailing three-month revenue. Days sales outstanding increased by 15 days from 63 days as of June 30, 2016, to 78 days as of June 30, 2017. Total receivables for purposes of the DSO calculation includes both billed and unbilled receivables as well as billings in excess of revenue recognized.

**Cash (used in) provided by investing activities**

For the six months ended June 30, 2017 cash used in investing activities of \$0.2 million is primarily purchases of property and equipment.

For the six months ended June 30, 2016 cash provided by investing activities of \$3.9 million was due to proceeds from the sale of the investments held in the Rabbi Trust for distribution to the plan participants.

## STG Group, Inc.

### Management's Discussion and Analysis

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#### *Cash used in financing activities*

For the six months ended June 30, 2017 and 2016 the increase in cash used in financing activities is due to payments due on the Company's long-term debt of \$2 million and \$1 million, respectively.

#### **Depreciation and Amortization**

Depreciation and amortization totaled \$0.1 million and \$0.3 million for each of the six months ended June 30, 2017 and 2016, respectively.

#### **Capital Expenditures**

Capital expenditures for property, plant, and equipment totaled \$0.1 million and \$0 million for the six months ended June 30, 2017 and 2016, respectively.

#### **Cash Paid for Income Taxes**

There were only immaterial cash paid for income taxes for the six months ended June 30, 2017 and \$0.6 million for the six months ended June 30, 2016.

#### **Off-Balance Sheet Arrangements**

There are no material changes to the disclosures regarding off-balance sheet arrangements made in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2016.

#### **Related Party Transactions**

A company owned by a party related to the majority stockholder of the Company is both a subcontractor to and customer of the Company on various contracts. As of June 30, 2017 no amounts were due from this entity. As of December 31, 2016, amounts due from this entity totaled \$0.01 million. The Company recorded revenue of \$0.01 million and \$0.3 million, respectively, for the six months ended June 30, 2017 and 2016.

No amount was due to this entity as of June 30, 2017 and December 31, 2016 for work performed under subcontracts. The Company also recorded no direct costs for both of the six months ended June 30, 2017 and 2016, for work performed.

On November 23, 2015, Global Strategies Group (North America) Inc., an affiliate of Holdings, and the Company entered into a services agreement, pursuant to which the Company may retain Global Strategies Group (North America) Inc. from time to time to perform certain services: corporate development services such as assisting the Company in post-integration matters, regulatory compliance support services, financial services and financial reporting, business development and strategic services, marketing and public relations services, and human resources services. Global Strategies Group (North America) Inc. is an affiliate of both the Company and a Board member. Amounts paid and expensed under this agreement during the six months ended June 30, 2017 and 2016 totaled \$0.3 million and 0.1 million, respectively.

#### **Critical Accounting Policies and Estimates**

There have been no significant changes to our Critical Accounting Policies and Estimates during the first quarter of 2017. Refer to our Critical Accounting Policies and Estimates section in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable

**ITEM 4. CONTROLS AND PROCEDURES**

*Evaluation of Disclosure Controls and Procedures*

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports the period covered by Company files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and that such information is accumulated and communicated to the Company’s management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

As of the end of the period covered by this Quarterly Report on Form 10-Q, we, including our principal executive officer and our principal financial officer, conducted an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based upon this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are not effective in timely alerting management of any material information relating to us that is required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 due to the material weakness in internal control over financial reporting described in “Management’s Report on Internal Control Over Financial Reporting” in Item 9A of our Annual Report on Form 10-K for the year ended December, 31, 2016.

*Remediation of Material Weaknesses in Internal Control over Financial Reporting*

Management is committed to improving our overall system of internal control over financial reporting, including taking necessary steps to fully remediate the identified material weakness identified as of December 31, 2015. Management determined that the Company's review and monitoring controls over the consolidated income tax provision failed to prevent or detect material errors in the calculation of the income tax provision for the year ended December 31, 2015, and that this was a material weakness in the Company's internal control over financial reporting. To assist with remediation of the material weakness in internal controls over Financial Reporting the Company identified at December 31, 2015, management has engaged a third party vendor to provide a comprehensive assessment of the Company's internal controls over financial reporting.

The comprehensive assessment of the Company's internal controls over financial reporting is currently in process. Although the activity completed to date has not yet identified any material weaknesses, including the review and monitoring controls over the consolidated income tax provision which resulted in the material weakness at December 31, 2015. We cannot conclude that no material weakness exists until the comprehensive assessment is complete and any identified findings have been remediated and tested.

Management believes that upon completion of the comprehensive assessment, such measures should be sufficient to remediate the identified material weaknesses and strengthen our internal control over financial reporting. We cannot assure you that these steps will remediate such weaknesses, nor can we be certain of whether additional actions will be required or the costs of any such actions.

*Changes in Internal Control Over Financial Reporting*

Other than in connection with the foregoing and the remedial action outlined above, there have been no changes in our internal control over financial reporting that occurred during the second fiscal quarter ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS.

We are not currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us or any of our officers and directors in their corporate capacity.

ITEM 1A. RISK FACTORS

There are no material changes to the disclosures regarding risk factors made in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December, 31, 2016, except as set forth in our Form 10-Q for the quarter ended March 31, 2017 and as follows:

*The agreements governing our indebtedness require us to comply with financial maintenance covenants. We were not in compliance with certain of these covenants as of March 31, 2017 and June 30, 2017, which could result in the lenders declaring an event of default under the Credit Agreement, causing our indebtedness under the Credit Agreement to become immediately due and payable. In the event the Lender exercises its rights to accelerate the repayment of the loan, our inability to repay the debt obligation in that scenario would cause substantial doubt about the Company's ability to continue as a going concern.*

Under our Credit Agreement, the Company is required to meet certain minimums for its fixed charge coverage ratio and consolidated EBITDA and certain maximums for its senior secured leverage ratio, as defined in the Credit Agreement (the "Specified Financial Covenants"). As of September 30, 2016, December 31, 2016, March 31, 2017, and June 30, 2017 the Company was not in compliance with the covenants related to the consolidated EBITDA and the senior secured leverage ratio and was also not in compliance with the Specified Financial Covenants as of June 30, 2017. The Company remained in compliance with the Credit Agreement as of September 30, 2016 by using a provision of the Credit Agreement that allowed us to cure (the "Cure Right") certain covenant non-compliance by issuance of Common Stock for cash and use of proceeds to reduce the principal balance of the term loan. As a result, pursuant to the Credit Agreement, the financial covenants were recalculated giving effect to the pay down of the debt, and we remained in compliance under the Credit Agreement.

As of December 31, 2016, we again did not satisfy the covenants relating to our required consolidated senior secured leverage ratio and minimum consolidated EBITDA. On February 24, 2017, we entered into a Limited Forbearance to Credit Agreement (the "February Forbearance Agreement") with MC Admin Co LLC and the other lenders under the Credit Agreement.

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The Company then entered into a Limited Waiver (“the Waiver”) from MC Admin Co LLC and other lenders under the Credit Agreement as of March 31, 2017, pursuant to which the lenders waived the Company’s noncompliance with the Specified Financial Covenants as of December 31, 2016. Pursuant to the Waiver:

- Loans under the Credit Agreement are subject to additional interest at a rate of 2% per annum until the earliest of (x) the date on which all loans are repaid and all commitments under the Credit Agreement are terminated, (y) the date we deliver the financial statements and certificates for the quarter ending March 31, 2017 showing that we are not in default under the Credit Agreement or (z) the date on which default interest is otherwise due under the Credit Agreement;
- We must obtain lender consent prior to using our revolving credit facility; and
- We could not effect a Cure Right in respect of the quarter ending March 31, 2017.

The Waiver does not apply to covenant non-compliance after December 31, 2016 or to covenants other than the Specified Financial Covenants.

As of March 31, 2017 the Company was not in compliance with the covenants related to the consolidated EBITDA the senior secured leverage ratio, and the Lender has not granted a waiver or forbearance. As of June 30, 2017 the Company was not in compliance with the Specified Financial Covenants, and the Lender has not granted a waiver or forbearance.

If our business continues to perform at the current level through that period, we do not expect to satisfy the Specified Financial Covenants at that time, and it is likely that we will be in non-compliance at September 30, 2017. An inability to meet the required covenant levels could have a material adverse impact on us, including the need for us to effect an additional Cure Right or obtain additional forbearance or an amendment, waiver, or other changes in the Credit Agreement. The Credit Agreement does not allow the Company to exercise the Cure Right in consecutive fiscal quarters, more than three fiscal quarters in the aggregate, or in more than two of any four fiscal quarters. The amount allowed under the Cure Right may not exceed the lesser of \$2.5 million and 20% of consolidated EBITDA. The aggregate of Cure Rights may not exceed \$5 million.

Any additional forbearance, amendment or waiver under the Credit Agreement may result in increased interest rates or premiums and more restrictive covenants and other terms less advantageous to us, and may require the payment of a fee for such forbearance, amendment or waiver. There can be no assurance that we would be able to obtain forbearance, a waiver or amendment, or effect a cure, on terms acceptable to us.

Even if the Lender does grant forbearance or an amendment to or waiver under the Credit Agreement, any future covenant non-compliance could give rise to an event of default thereunder.

If the Lender does not grant forbearance or an amendment to or waiver of our covenant non-compliance as of March 31, 2017 and June 30, 2017, the Budget Delivery Default, or any future covenant non-compliance, the indebtedness under the Credit Agreement could be declared immediately due and payable, which could have a material adverse effect on the Company.

STG Group, Inc.

**10Q – Part II**

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**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None

## ITEM 6. EXHIBITS

The following exhibits are filed as part of, or incorporated by reference into, this Quarterly Report on Form 10-Q.

Exhibit Number	Description	Incorporated by Reference			Filed or Furnished Herewith
		Form	Exhibit	Filing Date	
3.1	Amended and Restated Certificate of Incorporation	8-K	3.1	11/30/2015	
3.2	Amended and Restated Bylaws	8-K	3.2	11/30/2015	
10.1	Form of Notice of Restricted Stock Award and Restricted Stock Award Agreement				X
31.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X
101.INS	XBRL Instance Document				(1)
101.SCH	XBRL Taxonomy Schema				(1)
101.CAL	XBRL Taxonomy Calculation Linkbase				(1)
101.DEF	XBRL Taxonomy Definition Linkbase				(1)
101.LAB	XBRL Taxonomy Label Linkbase				(1)
101.PRE	XBRL Taxonomy Presentation Linkbase				(1)

(1) filed herewith electronically.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

**STG Group, Inc.**

Date: August 14, 2017

/s/ Phillip E. Lacombe

Name: Phillip E. Lacombe

Title: President (principal executive officer)

/s/ Charles L. Cosgrove

Name: Charles L. Cosgrove

Title: Chief Financial Officer (principal financial officer)

## EXHIBIT INDEX

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101.PRE	XBRL Taxonomy Presentation Linkbase				(1)

(1) filed herewith electronically.

STG GROUP, INC.  
(FORMERLY GLOBAL DEFENSE & NATIONAL SECURITY SYSTEMS, INC.)  
2015 OMNIBUS INCENTIVE PLAN

**NOTICE OF RESTRICTED STOCK AWARD**

Grantee's Name and Address: \_\_\_\_\_  
\_\_\_\_\_

You (the "Grantee") have been granted shares of Common Stock of the Company (the "Award"), subject to the terms and conditions of this Notice of Restricted Stock Award (the "Notice"), the Global Defense & National Security Systems, Inc. 2015 Omnibus Stock Incentive Plan (the "Plan"), as amended from time to time, and the Restricted Stock Award Agreement (the "Agreement") attached hereto, as follows. Unless otherwise defined herein, the terms defined in the Plan shall have the same defined meanings in this Notice.

Date of Award	•
Vesting Commencement Date	•
Total Number of Shares of	
Common Stock Awarded (the "Shares")	•

Vesting Schedule:

Subject to the Grantee's Continuous Service and other limitations set forth in this Notice, the Plan and the Agreement, the Shares will "vest" in accordance with the following schedule:

- Shares shall vest on the Date of Award.
- Shares shall vest on •; provided, that if prior to •, the Grantee's Continuous Service is terminated (i) by removal for Cause, by his resignation, or as a result of his refusal to stand for election, such Shares shall not vest and shall instead be forfeited immediately upon the occurrence of such termination, and (ii) for any reason other than as set forth in clause (i), such Shares shall vest immediately upon the occurrence of such termination.
- Shares shall vest on •; provided, that if prior to •, the Grantee's Continuous Service is terminated (i) by removal for Cause, by his resignation, or as a result of his refusal to stand for election, such Shares shall not vest and shall instead be forfeited immediately upon the occurrence of such termination, and (ii) for any reason other than as set forth in clause (i), such Shares shall vest immediately upon the occurrence of such termination.

In the event of the Grantee's change in status from Employee, Director or Consultant to any other status of Employee, Director or Consultant, the Shares shall continue to vest in accordance with the Vesting Schedule set forth above.

For purposes of this Notice and the Agreement, the term "vest" shall mean, with respect to any Shares, that such Shares are no longer subject to forfeiture to the Company. Shares that have not vested are deemed "Restricted Shares." If the Grantee would become vested in a fraction of a Restricted Share, such Restricted Share shall not vest until the Grantee becomes vested in the entire Share.

In the event the Grantee's Continuous Service is terminated by removal for Cause, by his resignation, or as a result of his refusal to stand for election any unvested Restricted Shares held by the Grantee shall be deemed reconveyed to the Company and the Company shall thereafter be the legal and beneficial owner of the Restricted Shares and shall have all rights and interest in or related thereto without further action by the Grantee. The foregoing forfeiture provisions set forth in this Notice as to Restricted Shares shall apply to the new capital stock or other property (including cash paid other than as a regular cash dividend) received in exchange for the Shares in consummation of any transaction described in Section 11 of the Plan and such stock or property shall be deemed Additional Securities (as defined in the Agreement) for purposes of the Agreement, but only to the extent the Shares are at the time covered by such forfeiture provisions.

The Award shall be subject to the provisions of Section 11 of the Plan in the event of a Corporate Transaction or Change in Control.

IN WITNESS WHEREOF, the Company and the Grantee have executed this Notice and agree that the Award is to be governed by the terms and conditions of this Notice, the Plan and the Agreement.

STG Group, Inc.,

By: \_\_\_\_\_

Title: \_\_\_\_\_

THE GRANTEE ACKNOWLEDGES AND AGREES THAT NOTHING IN THIS NOTICE, THE AGREEMENT NOR THE PLAN SHALL CONFER UPON THE GRANTEE ANY RIGHT WITH RESPECT TO CONTINUATION OF THE GRANTEE'S CONTINUOUS SERVICE, NOR SHALL IT INTERFERE IN ANY WAY WITH THE GRANTEE'S RIGHT OR THE COMPANY'S RIGHT TO TERMINATE THE GRANTEE'S CONTINUOUS SERVICE AT ANY TIME, WITH OR WITHOUT CAUSE, AND WITH OR WITHOUT NOTICE. THE GRANTEE ACKNOWLEDGES THAT UNLESS THE GRANTEE HAS A WRITTEN EMPLOYMENT AGREEMENT WITH THE COMPANY TO THE CONTRARY, THE GRANTEE'S STATUS IS AT WILL.

The Grantee acknowledges receipt of a copy of the Plan and the Agreement and represents that he or she is familiar with the terms and provisions thereof, and hereby accepts the Award subject to all of the terms and provisions hereof and thereof. The Grantee has reviewed this Notice, the Agreement and the Plan in their entirety, has had an opportunity to obtain the advice of counsel prior to executing this Notice and fully understands all provisions of this Notice, the Agreement and the Plan. The Grantee hereby agrees that all questions of interpretation and administration relating to this Notice, the Plan and the Agreement shall be resolved by the Administrator in accordance with Section 11 of the Agreement. The Grantee further agrees to the venue selection and waiver of a jury trial in accordance with Section 12 of the Agreement. The Grantee further agrees to notify the Company upon any change in the residence address indicated in this Notice.

Dated: \_\_\_\_\_

Signed: \_\_\_\_\_

**STG GROUP, INC.**  
**(FORMERLY GLOBAL DEFENSE & NATIONAL SECURITY SYSTEMS, INC.)**  
**2015 OMNIBUS INCENTIVE PLAN**

**RESTRICTED STOCK AWARD AGREEMENT**

1. **Issuance of Shares.** STG Group, Inc., a Delaware corporation (the “Company”), hereby issues to the Grantee (the “Grantee”) named in the Notice of Restricted Stock Award (the “Notice”), the Total Number of Shares of Common Stock Awarded set forth in the Notice (the “Shares”), subject to the Notice, this Restricted Stock Award Agreement (the “Agreement”) and the terms and provisions of the Company’s 2015 Omnibus Incentive Plan (the “Plan”), as amended from time to time, which are incorporated herein by reference. Unless otherwise defined herein, the terms defined in the Plan shall have the same defined meanings in this Agreement. All Shares issued hereunder will be deemed issued to the Grantee as fully paid and nonassessable shares, and the Grantee will have the right to vote the Shares at meetings of the Company’s stockholders. The Company shall pay any applicable stock transfer taxes imposed upon the issuance of the Shares to the Grantee hereunder.

2. **Transfer Restrictions.** The Shares issued to the Grantee hereunder may not be sold, transferred by gift, pledged, hypothecated, or otherwise transferred or disposed of by the Grantee prior to the date when the Shares become vested pursuant to the Vesting Schedule set forth in the Notice. Any attempt to transfer Restricted Shares in violation of this Section 2 will be null and void and will be disregarded.

3. **Escrow of Stock.** For purposes of facilitating the enforcement of the provisions of this Agreement, the Grantee agrees, immediately upon receipt of the certificate(s) for the Restricted Shares, to deliver such certificate(s), together with an Assignment Separate from Certificate in the form attached hereto as Exhibit A, executed in blank by the Grantee with respect to each such stock certificate, to the Secretary or Assistant Secretary of the Company, or their designee, to hold in escrow for so long as such Restricted Shares have not vested pursuant to the Vesting Schedule set forth in the Notice, with the authority to take all such actions and to effectuate all such transfers and/or releases as may be necessary or appropriate to accomplish the objectives of this Agreement in accordance with the terms hereof. The Grantee hereby acknowledges that the appointment of the Secretary or Assistant Secretary of the Company (or their designee) as the escrow holder hereunder with the stated authorities is a material inducement to the Company to make this Agreement and that such appointment is coupled with an interest and is accordingly irrevocable. The Grantee agrees that the Restricted Shares may be held electronically in a book entry system maintained by the Company’s transfer agent or other third party and that all the terms and conditions of this Section 3 applicable to certificated Restricted Shares will apply with the same force and effect to such electronic method for holding the Restricted Shares. The Grantee agrees that such escrow holder shall not be liable to any party hereto (or to any other party) for any actions or omissions unless such escrow holder is grossly negligent relative thereto. The escrow holder may rely upon any letter, notice or other document executed by any signature purported to be genuine and may resign at any time. Upon the vesting of Restricted Shares, the escrow holder will, without further order or instruction, transmit to the Grantee the certificate evidencing such Shares; *provided, however*, that no transmittal of certificates evidencing the Shares will occur unless and until the Grantee has satisfied all Tax Withholding Obligations (as defined in Section 5(b) below).

4. Additional Securities and Distributions.

(a) Any securities or cash received (other than a regular cash dividend) as the result of ownership of the Restricted Shares (the “Additional Securities”), including, but not by way of limitation, warrants, options and securities received as a stock dividend or stock split, or as a result of a recapitalization or reorganization or other similar change in the Company’s capital structure, shall be retained in escrow in the same manner and subject to the same conditions and restrictions as the Restricted Shares with respect to which they were issued, including, without limitation, the Vesting Schedule set forth in the Notice. The Grantee shall be entitled to direct the Company to exercise any warrant or option received as Additional Securities upon supplying the funds necessary to do so, in which event the securities so purchased shall constitute Additional Securities, but the Grantee may not direct the Company to sell any such warrant or option. If Additional Securities consist of a convertible security, the Grantee may exercise any conversion right, and any securities so acquired shall constitute Additional Securities. In the event of any change in certificates evidencing the Shares or the Additional Securities by reason of any recapitalization, reorganization or other transaction that results in the creation of Additional Securities, the escrow holder is authorized to deliver to the issuer the certificates evidencing the Shares or the Additional Securities in exchange for the certificates of the replacement securities.

(b) The Company shall disburse to the Grantee all regular cash dividends with respect to the Shares and Additional Securities (whether vested or not), less any applicable withholding obligations.

5. Taxes.

(a) Tax Liability. The Grantee is ultimately liable and responsible for all taxes owed by the Grantee in connection with the Award, regardless of any action the Company or any Related Entity takes with respect to any tax withholding obligations that arise in connection with the Award. Neither the Company nor any Related Entity makes any representation or undertaking regarding the treatment of any tax withholding in connection with the grant or vesting of the Award or the subsequent sale of Shares subject to the Award. The Company and its Related Entities do not commit and are under no obligation to structure the Award to reduce or eliminate the Grantee’s tax liability. The following provisions of this Section 5 and related provisions in this Agreement pertaining to withholding taxes shall not apply so long as the Grantee is providing services in a non-employee capacity.

(b) Payment of Withholding Taxes. Prior to any event in connection with the Award (e.g., vesting) that the Company determines may result in any tax withholding obligation, whether United States federal, state, local or non-U.S., including any employment tax obligation (the “Tax Withholding Obligation”), the Grantee must arrange for the satisfaction of the minimum amount of such Tax Withholding Obligation in a manner acceptable to the Company.

(i) *By Share Withholding.* The Grantee authorizes the Company to, upon the exercise of its sole discretion, withhold from those Shares issuable to the Grantee the whole number of Shares sufficient to satisfy the minimum applicable Tax Withholding Obligation. The Grantee acknowledges that the withheld Shares may not be sufficient to satisfy the Grantee's minimum Tax Withholding Obligation. Accordingly, the Grantee agrees to pay to the Company or any Related Entity as soon as practicable, including through additional payroll withholding, any amount of the Tax Withholding Obligation that is not satisfied by the withholding of Shares described above.

(ii) *By Check, Wire Transfer or Other Means.* At any time not less than five (5) business days (or such fewer number of business days as determined by the Administrator) before any Tax Withholding Obligation arises (e.g., a vesting date), the Grantee shall satisfy the Grantee's Tax Withholding Obligation by delivering to the Company an amount that the Company determines is sufficient to satisfy the Tax Withholding Obligation by (x) wire transfer to such account as the Company may direct, (y) delivery of a certified check payable to the Company, or (z) such other means as specified from time to time by the Administrator.

Notwithstanding the foregoing, the Company also may satisfy any Tax Withholding Obligation by offsetting any amounts (including, but not limited to, salary, bonus and severance payments) due to the Grantee by the Company.

(iii) *By Sale of Shares.* Notwithstanding (i) and (ii) above, the Company and Grantee may agree that the Grantee shall instruct and authorize the Company and any brokerage firm determined acceptable to the Company for such purpose to sell on the Grantee's behalf a whole number of Shares from those Shares issuable to the Grantee as the Company determines to be appropriate to generate cash proceeds sufficient to satisfy the minimum applicable Tax Withholding Obligation. Such Shares will be sold on the day such Tax Withholding Obligation arises (e.g., a vesting date) or as soon thereafter as practicable. The Grantee will be responsible for all broker's fees and other costs of sale, and the Grantee agrees to indemnify and hold the Company harmless from any losses, costs, damages, or expenses relating to any such sale. To the extent the proceeds of such sale exceed the Grantee's minimum Tax Withholding Obligation, the Company agrees to pay such excess in cash to the Grantee. The Grantee acknowledges that the Company or its designee is under no obligation to arrange for such sale at any particular price, and that the proceeds of any such sale may not be sufficient to satisfy the Grantee's minimum Tax Withholding Obligation. Accordingly, the Grantee agrees to pay to the Company or any Related Entity as soon as practicable, including through additional payroll withholding, any amount of the Tax Withholding Obligation that is not satisfied by the sale of Shares described above.

6. Stop-Transfer Notices. In order to ensure compliance with the restrictions on transfer set forth in this Agreement, the Notice or the Plan, the Company may issue appropriate "stop transfer" instructions to its transfer agent, if any, and, if the Company transfers its own securities, it may make appropriate notations to the same effect in its own records. The Company may issue a "stop transfer" instruction if the Grantee fails to satisfy any Tax Withholding Obligations.

7. Refusal to Transfer. The Company shall not be required (i) to transfer on its books any Shares that have been sold or otherwise transferred in violation of any of the provisions of this Agreement or (ii) to treat as owner of such Shares or to accord the right to vote or pay dividends to any purchaser or other transferee to whom such Shares shall have been so transferred.

8. Restrictive Legends. The Grantee understands and agrees that the Company shall cause the legends set forth below or legends substantially equivalent thereto, to be placed upon any certificate(s) evidencing ownership of the Shares together with any other legends that may be required by the Company or by state or federal securities laws:

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE RESTRICTED BY THE TERMS OF THAT CERTAIN RESTRICTED STOCK BONUS AWARD AGREEMENT BETWEEN THE COMPANY AND THE NAMED STOCKHOLDER. THE SHARES REPRESENTED BY THIS CERTIFICATE MAY BE TRANSFERRED ONLY IN ACCORDANCE WITH SUCH AGREEMENT, A COPY OF WHICH IS ON FILE WITH THE SECRETARY OF THE COMPANY.

9. Entire Agreement; Governing Law. The Notice, the Plan and this Agreement constitute the entire agreement of the parties with respect to the subject matter hereof and supersede in their entirety all prior undertakings and agreements of the Company and the Grantee with respect to the subject matter hereof, and may not be modified adversely to the Grantee's interest except by means of a writing signed by the Company and the Grantee. These agreements are to be construed in accordance with and governed by the internal laws of the State of Delaware without giving effect to any choice of law rule that would cause the application of the laws of any jurisdiction other than the internal laws of the State of Delaware to the rights and duties of the parties. Should any provision of the Notice or this Agreement be determined to be illegal or unenforceable, the other provisions shall nevertheless remain effective and shall remain enforceable.

10. Construction. The captions used in the Notice and this Agreement are inserted for convenience and shall not be deemed a part of the Award for construction or interpretation. Except when otherwise indicated by the context, the singular shall include the plural and the plural shall include the singular. Use of the term "or" is not intended to be exclusive, unless the context clearly requires otherwise.

11. Administration and Interpretation. Any question or dispute regarding the administration or interpretation of the Notice, the Plan or this Agreement shall be submitted by the Grantee or by the Company to the Administrator. The resolution of such question or dispute by the Administrator shall be final and binding on all persons.

12. Venue and Waiver of Jury Trial. The parties agree that any suit, action, or proceeding arising out of or relating to the Notice, the Plan or this Agreement shall be brought in the United States District Court for the Eastern District of Virginia (or should such court lack jurisdiction to hear such action, suit or proceeding, in a court of the Commonwealth of Virginia sitting in the County of Fairfax) and that the parties shall submit to the jurisdiction of such court. The parties irrevocably waive, to the fullest extent permitted by law, any objection the party may have to the laying of venue for any such suit, action or proceeding brought in such court. THE PARTIES ALSO EXPRESSLY WAIVE ANY RIGHT THEY HAVE OR MAY HAVE TO A JURY TRIAL OF ANY SUCH SUIT, ACTION OR PROCEEDING. If any one or more provisions of this Section 12 shall for any reason be held invalid or unenforceable, it is the specific intent of the parties that such provisions shall be modified to the minimum extent necessary to make it or its application valid and enforceable.

13. Notices. Any notice required or permitted hereunder shall be given in writing and shall be deemed effectively given (i) upon personal delivery, or (ii) two business days following deposit for delivery by an internationally recognized express mail courier service or deposit in the United States mail by certified mail (if the parties are within the United States), with postage and fees prepaid, addressed to the other party at its address as shown in these instruments, or to such other address as such party may designate in writing from time to time to the other party.

**END OF AGREEMENT**

**EXHIBIT A**

**STOCK ASSIGNMENT SEPARATE FROM CERTIFICATE**

In accordance with, and subject to the terms of, the Restricted Stock Award Agreement between STG Group, Inc. a Delaware corporation (the "Company") and the Company's 2015 Omnibus Incentive Plan, FOR VALUE RECEIVED, the undersigned hereby sells, assigns and transfers unto the Company, \_\_\_\_\_ (\_\_\_\_\_) shares of the Common Stock of the Company, standing in his name on the books of, the Company represented by Certificate No. herewith, and does hereby irrevocably constitute and appoint the Secretary of the Company attorney to transfer the said stock in the books of the Company with full power of substitution.

DATED: \_\_\_\_\_

\_\_\_\_\_  
Name:

**[Please sign this document but do not date it. The date and information of the transferee will be completed if and when the shares are assigned.]**

**Exhibit 31.1**

CERTIFICATION PURSUANT TO  
RULE 13a – 14(a) or RULE 15d – 14(a)  
OF THE SECURITIES EXCHANGE ACT OF 1934

I, Phillip E Lacombe, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2017 of STG Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2017

/s/ Phillip E. Lacombe

Phillip E. Lacombe  
President and Chief Operating Officer  
(principal executive officer)

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**Exhibit 31.2**

CERTIFICATION PURSUANT TO  
RULE 13a – 14(a) or RULE 15d – 14(a)  
OF THE SECURITIES EXCHANGE ACT OF 1934

I, Charles L. Cosgrove, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2017 of STG Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2017

/s/ Charles L. Cosgrove

Charles L. Cosgrove  
Chief Financial Officer  
(principal financial officer)

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**Exhibit 32.1**

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of STG Group, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Phillip E. Lacombe, President and Chief Operating Officer of STG Group, Inc. (the "Company"), certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2017

/s/ Phillip E. Lacombe

Phillip E. Lacombe  
President and Chief Operating Officer  
(principal executive officer)

A signed original of this written statement required by Section 906 has been provided to STG Group, Inc. and will be retained by STG Group, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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**Exhibit 32.2**

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of STG Group, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Charles L. Cosgrove, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2017

/s/ Charles L. Cosgrove

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Charles L. Cosgrove  
Chief Financial Officer  
(principal financial officer)

A signed original of this written statement required by Section 906 has been provided to STG Group, Inc. and will be retained by STG Group, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

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