

SURGE COMPONENTS INC  
Form 10-Q  
July 15, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For The Quarterly Period Ended May 31, 2016**

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

*COMMISSION FILE NUMBER 000-27688*

**SURGE COMPONENTS, INC.**

(Exact name of registrant as specified in its charter)

**Nevada**  
(State or other jurisdiction of  
incorporation or organization)

**11-2602030**  
(I.R.S. Employer  
Identification No.)

**95 East Jefryn Blvd., Deer Park, New York 11729**

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(Address of principal executive offices) (Zip code)

Issuer's telephone number: **(631) 595-1818**

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 during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).  
Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

As of July 15, 2016, there were 10,091,353 outstanding shares of the Registrant's Common Stock, \$.001 par value.

**SURGE COMPONENTS, INC**

**TABLE OF CONTENTS**

|   | <b>Page</b> |
|---|-------------|
| <b>PART I - FINANCIAL INFORMATION</b>   |             |
| Item 1. Financial Statements  | 3           |
| Consolidated Balance Sheets as of May 31, 2016 (unaudited) and November 30, 2015  | 3           |
| Consolidated Statements of Operations for the six months and three ended May 31, 2016 and May 31, 2015 (unaudited)        | 5           |
| Consolidated Statements of Cash Flows for the six months and three months ended May 31, 2016 and May 31, 2015 (unaudited) | 6           |
| Notes to Consolidated Financial Statements (unaudited)  | 8           |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations                             | 21          |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk  | 25          |
| Item 4. Controls and Procedures   | 25          |
| <b>PART II - OTHER INFORMATION</b>  |             |
| Item 1. Legal Proceedings   | 26          |
| Item 1A. Risk Factors   | 26          |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds   | 26          |
| Item 3. Defaults Upon Senior Securities   | 26          |
| Item 4. Mine Safety Disclosures   | 26          |
| Item 5. Other Information   | 26          |
| Item 6. Exhibits  | 27          |
| SIGNATURES  | 28          |



**PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS.**

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

|  | May 31,<br>2016 | November<br>30,<br>2015 |
|--|-----------------|-------------------------|
|  | (unaudited)     |                         |
| <b>ASSETS</b>  |                 |                         |
| Current assets:  |                 |                         |
| Cash   | \$7,234,406     | \$7,169,118             |
| Accounts receivable - net of allowance for doubtful accounts of \$143,093 and \$127,531        | 4,200,038       | 4,693,749               |
| Inventory, net   | 3,493,977       | 3,199,463               |
| Prepaid expenses and income taxes  | 161,226         | 131,522                 |
| Deferred income taxes  | 337,324         | 249,533                 |
| Total current assets   | 15,426,971      | 15,443,385              |
| Fixed assets – net of accumulated depreciation and amortization of \$2,169,814 and \$2,154,182 | 90,627          | 104,738                 |
| Deferred income taxes  | 674,648         | 748,597                 |
| Other assets   | 13,384          | 13,384                  |
| Total assets   | \$16,205,630    | \$16,310,104            |

See notes to consolidated financial statements

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

(Continued)

|   | May 31,<br>2016<br>(unaudited) | November 30,<br>2015 |
|---|--------------------------------|----------------------|
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                                |                      |
| Current liabilities:  |                                |                      |
| Accounts payable  | \$3,384,562                    | \$3,261,763          |
| Accrued expenses and taxes  | 542,091                        | 572,487              |
| Accrued salaries  | 274,042                        | 528,957              |
| Total current liabilities   | 4,200,695                      | 4,363,207            |
| Deferred rent   | 41,245                         | 41,955               |
| Total liabilities   | 4,241,940                      | 4,405,162            |
| Commitments and contingencies   |                                |                      |
| Shareholders' equity  |                                |                      |
| Preferred stock - \$.001 par value stock, 5,000,000 shares authorized:  |                                |                      |
| Series A – 260,000 shares authorized, none outstanding, non-voting, convertible, redeemable.  |                                |                      |
| Series B – 200,000 shares authorized, none outstanding, voting, convertible, redeemable.  |                                |                      |
| Series C–100,000 shares authorized, 10,000 and 10,000 shares issued and outstanding, redeemable, convertible, and a liquidation preference of \$5 per share | 10                             | 10                   |
| Common stock - \$.001 par value stock, 75,000,000 shares authorized, 10,095,453 and 9,999,125 shares issued and outstanding                                 | 10,096                         | 9,999                |
| Additional paid-in capital  | 23,601,708                     | 23,529,729           |
| Accumulated deficit   | (11,648,124)                   | (11,634,796 )        |
| Total shareholders' equity  | 11,963,690                     | 11,904,942           |
| Total liabilities and shareholders' equity  | \$16,205,630                   | \$16,310,104         |

See notes to consolidated financial statements.



## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Consolidated Statements of Operations

(Unaudited)

|   | Six Months Ended |              | Three Months Ended |             |
|---|------------------|--------------|--------------------|-------------|
|   | May 31,<br>2016  | 2015         | May 31,<br>2016    | 2015        |
| Net sales   | \$13,396,453     | \$14,078,890 | \$7,080,442        | \$7,119,265 |
| Cost of goods sold  | 10,104,591       | 10,372,989   | 5,444,592          | 5,258,324   |
| Gross profit  | 3,291,862        | 3,705,901    | 1,635,850          | 1,860,941   |
| Operating expenses:   |                  |              |                    |             |
| Selling and shipping expenses                                 | 1,191,146        | 1,167,070    | 665,300            | 617,508     |
| General and administrative expenses                           | 2,088,975        | 1,962,472    | 1,090,073          | 957,742     |
| Depreciation and amortization                                 | 15,632           | 17,480       | 7,816              | 8,957       |
| Total operating expenses                                      | 3,295,753        | 3,147,022    | 1,763,189          | 1,584,207   |
| Loss (income) before other income (expense) and income taxes  | (3,891 )         | 558,879      | (127,339 )         | 276,734     |
| Other income  |                  |              |                    |             |
| Investment income   | 4,083            | 4,305        | 2,758              | 2,308       |
| Other income  | 4,083            | 4,305        | 2,758              | 2,308       |
| Loss (income) before income taxes                             | 192              | 563,184      | (124,581 )         | 279,042     |
| Income taxes  | 13,520           | 140,183      | (16,782 )          | 56,358      |
| Net loss (income)   | (13,328 )        | 423,001      | (107,799 )         | 222,684     |
| Dividends on preferred stock                                  | 2,500            | 5,425        | —                  | —           |
| Net loss (income) available to common shareholders            | \$(15,828 )      | \$417,576    | \$(107,799 )       | \$222,684   |
| Net loss (income) per share available to common shareholders: |                  |              |                    |             |



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|         |        |        |         |          |
|---------|--------|--------|---------|----------|
| Basic   | \$ .00 | \$ .04 | \$( .01 | ) \$ .02 |
| Diluted | \$ .00 | \$ .04 | \$( .01 | ) \$ .02 |

Weighted Shares Outstanding:

|         |            |           |            |           |
|---------|------------|-----------|------------|-----------|
| Basic   | 10,002,065 | 9,290,532 | 10,004,964 | 9,485,943 |
| Diluted | 10,002,065 | 9,458,841 | 10,004,964 | 9,654,251 |

See notes to consolidated financial statements.

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(unaudited)

|  | Six Months Ended |                  |
|--|------------------|------------------|
|  | May 31,<br>2016  | May 31,<br>2015  |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                  |                  |
| Net loss (income)  | \$(13,328 )      | \$423,001        |
| Adjustments to reconcile net loss (income) to net cash provided by operating activities: |                  |                  |
| Depreciation and amortization  | 15,632           | 17,480           |
| Stock compensation expense   | 74,363           | 72,167           |
| Deferred income taxes  | (13,842 )        | 130,982          |
| Allowance for doubtful accounts  | 15,562           | 16,883           |
| <b>CHANGES IN OPERATING ASSETS AND LIABILITIES:</b>                                      |                  |                  |
| Accounts receivable  | 478,149          | (65,685 )        |
| Inventory  | (294,514)        | (458,201)        |
| Prepaid expenses and income taxes  | (29,704 )        | 27,425           |
| Other assets   | -                | -                |
| Accounts payable   | 122,799          | 804,704          |
| Deferred rent  | (710 )           | 976              |
| Accrued expenses   | (285,311)        | (393,921)        |
| <b>NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES</b>                                   | <b>69,096</b>    | <b>575,811</b>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                  |                  |
| Acquisition of fixed assets  | (1,521 )         | (54,826 )        |
| <b>NET CASH FLOWS USED IN INVESTING ACTIVITIES</b>                                       | <b>(1,521 )</b>  | <b>(54,826 )</b> |

See notes to consolidated financial statements

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Consolidated Statements Of Cash Flows

(unaudited)

(Continued)

|  | Six Months Ended   |                    |
|--|--------------------|--------------------|
|  | May 31,<br>2016    | May 31,<br>2015    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                     |                    |                    |
| Repurchases of common stock                                      | \$(2,287           | ) \$-              |
| Proceeds from exercising stock options                           | -                  | 143,750            |
| <b>NET CASH FLOWS (USED IN) PROVIDED BY FINANCING ACTIVITIES</b> | <b>(2,287</b>      | <b>) 143,750</b>   |
| <b>NET CHANGE IN CASH</b>  | <b>65,288</b>      | <b>664,735</b>     |
| <b>CASH AT BEGINNING OF PERIOD</b>                               | <b>7,169,118</b>   | <b>6,174,561</b>   |
| <b>CASH AT END OF PERIOD</b>                                     | <b>\$7,234,406</b> | <b>\$6,839,296</b> |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>         |                    |                    |
| Income taxes paid  | \$34,865           | \$8,978            |
| Interest paid  | \$-                | \$-                |
| <b>NONCASH INVESTING AND FINANCING ACTIVITIES:</b>               |                    |                    |
| Accrued dividends on preferred stock                             | \$2,500            | \$5,425            |
| Payment of accrued interest through issuance of common stock     | \$-                | \$102,399          |

See notes to consolidated financial statements.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE A – ORGANIZATION, DESCRIPTION OF COMPANY'S BUSINESS AND BASIS OF PRESENTATION

Surge Components, Inc. (“Surge”) was incorporated in the State of New York and commenced operations on November 24, 1981 as an importer of electronic products, primarily capacitors and discrete semi-conductors selling to customers located principally throughout North America. On June 24, 1988, Surge formed Challenge/Surge Inc. (“Challenge”), a wholly-owned subsidiary to engage in the sale of electronic component products and sounding devices from established brand manufacturers to customers located principally throughout North America.

In May 2002, Surge and an officer of Surge founded and became sole owners of Surge Components, Limited (“Surge Limited”), a Hong Kong corporation. Under current Hong Kong law, Surge Limited is required to have at least two shareholders. Surge owns 999 shares of the outstanding common stock and the officer of Surge owns 1 share of the outstanding common stock. The officer of Surge has assigned his rights regarding his 1 share to Surge. Surge Limited started doing business in July 2002. Surge Limited operations have been consolidated with the Company. Surge Limited is responsible for the sale of Surge’s products to customers located in Asia.

On August 31, 2010, the Company changed its corporate domicile by merging into a newly-formed corporation, Surge Components, Inc. (Nevada), which was formed in the State of Nevada for that purpose. Surge Components Inc. is the surviving entity. The number of common stock shares authorized for issuance was increased to 75,000,000 shares.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) Principles of Consolidation:

The consolidated financial statements include the accounts of Surge, Challenge, and Surge Limited (collectively the “Company”). All material intercompany balances and transactions have been eliminated in consolidation.

The accompanying interim consolidated financial statements have been prepared without audit, in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the Securities and Exchange Commission.

The results and trends in these interim consolidated financial statements for the six months ended May 31, 2016 and May 31, 2015 may not be representative of those for the full fiscal year or any future periods.

(2) Accounts Receivable:

Trade accounts receivable are recorded at the net invoice value and are not interest bearing. The Company considers receivables past due based on the payment terms. The Company reviews its exposure to accounts receivable and reserves specific amounts if collectability is no longer reasonably assured. The Company also reserves a percentage of its trade receivable balance based on collection history and current economic trends that might impact the level of future credit losses. The Company re-evaluates such reserves on a regular basis and adjusts its reserves as needed. Based on the Company's operating history and customer base, bad debts to date have not been material.

(3) Revenue Recognition:

Revenue is recognized for products sold by the Company when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed and determinable, collectability is reasonably assured and title and risk of loss have been transferred to the customer. This occurs when product is shipped from the Company's warehouse.

For direct shipments, revenue is recognized when product is shipped from the Company's supplier. The Company has a long term supply agreement with one of its suppliers. The Company purchases the merchandise from the supplier and has the supplier directly ship the merchandise to the customer through a freight forwarder. Title passes to the customer upon the merchandise being received by a freight forwarder. Direct shipments were approximately \$1,783,000 and \$1,727,000 for the six months ended May 31, 2016 and May 31, 2015 respectively.

The Company also acts as a sales agent to certain customers in North America for one of its suppliers. The Company reports these commissions as revenues in the period earned. Commission revenue totaled \$177,963 and \$113,998 for the six months ended May 31, 2016 and May 31, 2015 respectively.

The Company performs ongoing credit evaluations of its customers and maintains reserves for potential credit losses.



SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(3) Revenue Recognition (continued):

The Company and its subsidiaries currently have agreements with several distributors. There are no provisions for the granting of price concessions in any of the agreements. Revenues under these distribution agreements were approximately \$3,946,000 and \$4,680,000 for the six months ended May 31, 2016 and May 31, 2015 respectively.

(4) Inventories:

Inventories, which consist solely of products held for resale, are stated at the lower of cost (first-in, first-out method) or market. Products are included in inventory when the Company obtains title and risk of loss on the products, primarily when shipped from the supplier. Inventory in transit principally from foreign suppliers at May 31, 2016 approximated \$1,536,000. The Company, at May 31, 2016, has a reserve against slow moving and obsolete inventory of \$313,000. From time to time the Company's products are subject to legislation from various authorities on environmental matters.

(5) Depreciation and Amortization:

Fixed assets are recorded at cost. Depreciation is generally calculated on a straight line method and amortization of leasehold improvements is provided for on the straight-line method over the estimated useful lives of the various assets as follows:

|                                   |             |
|-----------------------------------|-------------|
| Furniture, fixtures and equipment | 5 - 7 years |
| Computer equipment                | 5 years     |

Leasehold Improvements                      Estimated useful life or lease term, whichever is shorter

Maintenance and repairs are expensed as incurred while renewals and betterments are capitalized.



SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(6) Concentration of Credit Risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of accounts receivable. The Company maintains substantially all of its cash balances in a limited number of financial institutions. At May 31, 2016 and November 30, 2015, the Company's uninsured cash balances totaled approximately \$4,006,000 and \$3,989,000, respectively.

(7) Income Taxes:

The Company's deferred income taxes arise primarily from the differences in the recording of net operating losses, allowances for bad debts, inventory reserves and depreciation expense for financial reporting and income tax purposes. A valuation allowance is provided when it has been determined to be more likely than not that the likelihood of the realization of deferred tax assets will not be realized. See Note G.

The Company follows the provisions of the Accounting Standards Codification topic, ASC 740, "Income Taxes" (ASC 740). There have been no unrecognized tax benefits and, accordingly, there has been no effect on the Company's financial condition or results of operations as a result of ASC 740.

The Company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The Company is no longer subject to U.S. federal tax examinations for years before fiscal years ending November 30, 2011, and state tax examinations for years before fiscal years ending November 30, 2010. Management does not believe there will be any material changes in our unrecognized tax positions over the next twelve months.

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income expense. As of the date of adoption of ASC 740, there was no accrued interest or penalties associated with any unrecognized benefits, nor was any interest expense recognized during the six months ended May 31, 2016 and May 31, 2015.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(8) Cash Equivalents:

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

(9) Use of Estimates:

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

(10) Marketing and promotional costs:

Marketing and promotional costs are expensed as incurred and have not been material to date. The Company has contractual arrangements with several of its distributors which provide for cooperative advertising rights to the distributor as a percentage of sales. Cooperative advertising is reflected as a reduction in revenues and has not been material to date.

(11) Fair Value of Financial Instruments:

The carrying amount of cash balances, accounts receivable, accounts payable and accrued expenses approximate their fair value based on the nature of those items. Estimated fair values of financial instruments are determined using available market information and appropriate valuation methodologies. Considerable judgment is required to interpret the market data used to develop the estimates of fair value, and accordingly, the estimates are not necessarily indicative of the amounts that could be realized in a current market exchange.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(12) Shipping Costs

The Company classifies shipping costs as a component of selling expenses. Shipping costs totaled \$3,465 and \$4,926 for the six months ended May 31, 2016 and May 31, 2015 respectively.

(13) Earnings Per Share

Basic earnings per share includes no dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. The difference between reported basic and diluted weighted-average common shares results from the assumption that all dilutive stock options and convertible preferred stock exercised into common stock. The Company had a net loss for the six and three months ended May 31, 2016 and accordingly, potential dilutive common shares have been excluded from this calculation as the effect would be anti-dilutive. The number of potentially dilutive shares excluded from diluted weighted shares outstanding at May 31, 2016 and May 31, 2015 totaled 635,438 and 390,130, respectively.

(14) Stock Based Compensation

*Stock Based Compensation to Employees*

The Company accounts for its stock-based compensation for employees in accordance with Accounting Standards Codification (“ASC”) 718. The Company recognizes in the statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees and non-employees over the related vesting period.

*Stock Based Compensation to Other than Employees*

The Company accounts for equity instruments issued in exchange for the receipt of goods or services from other than employees in accordance with ASC 718. Costs are measured at the estimated fair market value of the consideration received or the estimated fair value of the equity instruments issued, whichever is more reliably determinable. The value of equity instruments issued for consideration other than employee services is determined on the earlier of a performance commitment or completion of performance by the provider of goods or services. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement.

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

NOTE C - FIXED ASSETS

Fixed assets consist of the following:

|                               | May 31,<br>2016 | November<br>30,<br>2015 |
|-------------------------------|-----------------|-------------------------|
| Furniture and Fixtures        | \$327,971       | \$327,971               |
| Leasehold Improvements        | 956,637         | 956,637                 |
| Computer Equipment            | 975,833         | 974,312                 |
| Less-Accumulated Depreciation | (2,169,814)     | (2,154,182)             |
| Net Fixed Assets              | \$90,627        | \$104,738               |

Depreciation and amortization expense for the six months ended May 31, 2016 and May 31, 2015 was \$15,632 and \$17,480, respectively.

NOTE D - ACCRUED EXPENSES

Accrued expenses consist of the following:

|                           | May 31,<br>2016 | November<br>30,<br>2015 |
|---------------------------|-----------------|-------------------------|
| Commissions               | \$231,271       | \$276,724               |
| Preferred Stock Dividends | 126,569         | 124,069                 |
| Other accrued expenses    | 184,251         | 171,694                 |

\$542,091 \$572,487

NOTE E – RETIREMENT PLAN

In June 1997, the Company adopted a qualified 401(k) retirement plan for all full-time employees who are twenty-one years of age and have completed twelve months of service. The plan allows total employee contributions of up to fifteen percent (15%) of the eligible employee's salary through salary reduction. The Company makes a matching contribution of twenty percent (20%) of each employee's contribution for each dollar of employee deferral up to five percent (5%) of the employee's salary. Net assets for the plan, as estimated by Union Central, Inc., which maintains the plan's records, were approximately \$1,092,000 at November 30, 2015. Pension expense for the six months ended May 31, 2016 and May 31, 2015 was \$1,193 and \$1,613, respectively.



SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE F – SHAREHOLDERS’ EQUITY

[1] Preferred Stock:

In February 1996, the Company amended its Certificate of Incorporation to authorize the issuance of 1,000,000 shares of preferred stock in one or more series. In August 2010, the number of preferred shares authorized for issuance was increased to 5,000,000 shares.

In January 2000, the Company authorized 260,000 shares of preferred stock as Non-Voting Redeemable Convertible Series A Preferred Stock (“Series A Preferred”). As of November 30, 2015, none of the Series A preferred stock was outstanding.

In November 2000, the Company authorized 200,000 shares of preferred stock as Voting Redeemable Convertible Series B Preferred Stock (“Series B Preferred”). As of November 30, 2015, none of the Series B Preferred Stock was outstanding.

In November 2000, the Company authorized 100,000 shares of preferred stock as Non-Voting Redeemable Convertible Series C Preferred Stock (“Series C Preferred”). Each share of Series C Preferred is automatically convertible into 10 shares of our common stock upon shareholder approval. If the Series C Preferred were converted into common stock on or before April 15, 2001, these shares were entitled to cumulative dividends at the rate of \$.50 per share per annum commencing April 15, 2001 payable on June 30 and December 31 of each year. In November 2000, 70,000 shares of the Series C Preferred were issued in payment of financial consulting services to its investment banker and a shareholder of the Company. In April 2001, 8,000 shares of the Series C Preferred were repurchased and cancelled.

In April 2002, in connection with a Mutual Release, Settlement, Standstill and Non-Disparagement Agreement among other provisions, certain investors transferred back to the Company 252,000 shares of common stock, 19,300 shares of

Series C preferred stock, and certain warrants, in exchange for \$225,000. These repurchased shares were cancelled.

In February 2006, the Company settled with a shareholder to repurchase 10,000 shares of Series C Preferred plus accrued dividends for \$50,000.

Pursuant to exchange agreements dated as of March 14, 2011, 9,000 shares of Series C Preferred were returned to the Company for cancellation in exchange for 112,500 shares of common stock.

In October 2014, 2,000 shares of Series C Preferred were converted into 20,000 shares of common stock.

In April 2015, the Company entered into a settlement agreement with a shareholder pursuant to which 7,500 shares of Series C Preferred were returned to the Company for cancellation in exchange for 110,000 shares of common stock plus \$65,000 for accrued dividends and legal fees and expenses.

In July 2015, 4,200 shares of Series C Preferred were exchanged for 42,000 shares of common stock and \$29,838 in accrued dividends.

Dividends aggregating \$126,569 have not been paid for the semi-annual periods ended December 31, 2001 through the semi-annual payment due December 31, 2015. The Company has accrued these dividends. At May 31, 2016, there are 10,000 shares of Series C Preferred issued and outstanding.

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

NOTE F – SHAREHOLDERS’ EQUITY (Continued)[2] 2010 Incentive Stock Plan

In March 2010, the Company adopted, and in April 2010 the shareholders ratified, the 2010 Incentive Stock Plan (“2010 Stock Plan”). The 2010 Stock Plan provides for the grant of options to officers, employees, directors or consultants to the Company to purchase an aggregate of 1,500,000 common shares.

Activity in the 2010 Stock Plan for the quarter ended May 31, 2016 is summarized as follows:

|  | Shares  | Weighted<br>Average<br>Exercise<br>Price |
|--|---------|--|
| Options outstanding December 1, 2015                   | 535,438 | \$ 0.85                                  |
| Options issued in the six months ended May 31, 2016    | -       | \$ -                                     |
| Options exercised in the six months ended May 31, 2016 | -       | \$ -                                     |
| Options cancelled in the six months ended May 31, 2016 | -       | \$ -                                     |
| Options outstanding at May 31, 2016                    | 535,438 | \$ 0.85                                  |
| Options exercisable at May 31, 2016                    | 535,438 | \$ .085                                  |

[3] 2015 Incentive Stock Plan

In November 2015, the Company adopted, and its shareholders ratified, the 2015 Incentive Stock Plan (“2015 Stock Plan”). The 2015 Stock Plan provides for the grant of awards to officers, employees, directors or consultants to the Company to purchase up to an aggregate of 1,500,000 shares of common stock.

In April 2016, the Company awarded one employee director 67,901 shares of its common stock and another employee director 31,250 shares of its common stock from the 2015 Incentive Stock Plan as part of their 2015 bonus. The Company recorded a cost of \$74,363 relating to the issuance of these shares.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE F – SHAREHOLDERS’ EQUITY (Continued)

Stock Compensation

In March 2015, the Company awarded one employee director 48,530 shares of its common stock and another employee director 29,780 shares of its common stock as part of their 2014 bonus. The Company recorded a cost of \$57,166 relating to the issuance of these shares. In February 2015, one non-employee director exercised an option to acquire 25,000 shares of common stock for \$0.25 per share. In April 2015, two employee directors each exercised options to acquire 250,000 shares for \$0.25 per share. Also in April 2015, two non-employee directors each exercised options to acquire 25,000 shares of common stock for \$0.25 per share.

In July 2015, the Company granted stock options to (a) three non-employee directors to each purchase 25,000 shares of common stock, and (b) one non-employee-director to purchase 50,000 shares of common stock, at an exercise price of \$.87 per share, the market price of the common stock on the date of the grant. These options vest immediately and expire five years from the grant date. The Company recorded a cost of \$19,913 related to the granting of these options. The fair value of these stock options are estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: expected volatility of 17% (based on the Company’s historical stock volatility); average risk-free interest rate of 1.55% (the five year treasury note rate on the date of the grant); initial expected life of 5 years (based on the term of the options) and no expected dividend yield.

In April 2016, the Company awarded one employee director 67,901 shares of its common stock and another employee director 31,250 shares of its common stock from the 2015 Incentive Stock Plan as part of their 2015 bonus. The Company recorded a cost of \$74,363 relating to the issuance of these shares.

The intrinsic value of the exercisable options at May 31, 2016 totaled \$12,000. At May 31, 2016, the weighted average remaining life of the stock options is 2.19 years. At May 31, 2016, there was no unrecognized compensation cost related to the stock options granted under the Company’s incentive plans.



SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE F – SHAREHOLDERS’ EQUITY (Continued)

[4] Authorized Repurchase:

In November 2015, the Board of Directors authorized the Company to purchase up to \$500,000 of common stock in the open market or in privately negotiated transactions. Pursuant to such authority and pursuant to Rule 10b-18 under the Securities Exchange Act of 1934, as amended (“Exchange Act”), as of May 31, 2016 a total of 2,823 shares have been repurchased.

[5] Compensation of Directors

In February 2015, one non-employee director exercised an option and acquired 25,000 shares of common stock for \$0.25 per share. In April 2015, two non-employee directors exercised options and acquired 25,000 shares each of common stock for \$0.25 per share. In July 2015, options were granted to three non-employee directors each to purchase 25,000 shares of common stock and one non-employee director to purchase 50,000 shares of common stock at an exercise price of \$0.87 per share.

NOTE G – INCOME TAXES

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes using the enacted tax rates in effect in the years in which the differences are expected to reverse.

The Company’s deferred income taxes are comprised of the following:

|                           | May 31,<br>2016 | November<br>30,<br>2015 |
|---------------------------|-----------------|-------------------------|
| Deferred Tax Assets       |                 |                         |
| Net operating loss        | \$4,103,641     | \$4,095,388             |
| Allowance for bad debts   | 44,286          | 39,296                  |
| Inventory                 | 62,409          | 100,017                 |
| Deferred Rent             | 16,474          | 16,756                  |
| Depreciation              | 154,941         | 156,272                 |
| Total deferred tax assets | 4,381,751       | 4,407,729               |
| Valuation allowance       | (3,369,779)     | (3,409,599)             |
| Deferred Tax Assets       | \$1,011,972     | \$998,130               |

The valuation allowance for the deferred tax assets relates principally to the uncertainty of the utilization of deferred tax assets and was calculated in accordance with the provisions of ASC 740, which requires that a valuation allowance be established or maintained when it is “more likely than not” that all or a portion of deferred tax assets will not be realized. The valuation allowance decreased by approximately \$40,000 during the six months ended May 31, 2016. This valuation is based on management estimates of future taxable income. Although the degree of variability inherent in the estimates of future taxable income is significant and subject to change in the near term, management believes, that the estimate is adequate. The estimated valuation allowance is continually reviewed and as adjustments to the allowance become necessary, such adjustments are reflected in the current operations.



## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

NOTE G – INCOME TAXES (CONTINUED)

The Company's income tax expense consists of the following:

|                            | Six Months Ended |                 |
|----------------------------|------------------|-----------------|
|                            | May 31,<br>2016  | May 31,<br>2015 |
| Current:                   |                  |                 |
| Federal                    | \$--             | \$4,627         |
| States                     | 27,362           | 4,574           |
|                            | 27,362           | 9,201           |
| Deferred:                  |                  |                 |
| Federal                    | (10,935)         | 106,724         |
| States                     | (2,907 )         | 24,258          |
|                            | (13,842)         | 130,982         |
| Provision for income taxes | \$ 13,520        | \$ 140,183      |

The Company files a consolidated income tax return with its wholly-owned subsidiaries and has net operating loss carryforwards of approximately \$10,202,000 for federal and state purposes, which expire through 2020. A reconciliation of the difference between the expected income tax rate using the statutory federal tax rate and the Company's effective rate is as follows:

Six  
Months  
Ended  
May  
31, 31,  
2016 2015

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|                                       |   |    |   |
|---------------------------------------|---|----|---|
| U.S Federal Income tax statutory rate | * | 34 | % |
| Valuation allowance                   | * | 14 | % |
| State income taxes                    | * | 5  | % |
| Other                                 | - | -  |   |
| Effective tax rate                    | * | 25 | % |

\* Due to the amount of the net income (loss), the presentation of the reconciliation of the effective rate is not meaningful.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE H- RENTAL COMMITMENTS

The Company leases its office and warehouse space through 2020 from a corporation that is controlled by officers/shareholders of the Company (“Related Company”). Annual minimum rental payments to the Related Company approximated \$169,000 for the year ended November 30, 2015, and increase at the rate of three per cent per annum throughout the lease term.

Pursuant to the lease, rent expense charged to operations differs from rent paid because of scheduled rent increases. Accordingly, the Company has recorded deferred rent. Rent expense is calculated by allocating to rental payments, including those attributable to scheduled rent increases, on a straight line basis, over the lease term.

In June 2015, the Company renewed its lease to rent office space and a warehouse in Hong Kong for two years. Annual minimum rental payments for this space are approximately \$58,500.

The Company’s future minimum rental commitments at May 31, 2016 are as follows:

|                             |           |
|-----------------------------|-----------|
| Twelve Months Ended May 31, |           |
| 2017                        | \$236,247 |
| 2018                        | \$186,213 |
| 2019                        | \$184,968 |
| 2020                        | \$62,061  |
|                             | \$669,489 |

Net rental expense for the six months ended May 31, 2016 and May 31, 2015 were \$155,269 and \$151,254, respectively, of which \$126,348 and \$124,662, respectively, were paid to the Related Company.



SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE I – EMPLOYMENT AND OTHER AGREEMENTS

In February 2016, the Company entered into revised employment agreements with two officers of the Company. Pursuant to these agreements, the base salary for one officer is \$275,000 and the base salary for the other officer is \$225,000. The agreements continue until terminated by either party.

The Company's compensation committee will review the base salary amounts for each of the officers on an annual basis to determine if any changes to the base salary amounts need to be made and may also award these officers with annual bonuses. Pursuant to the agreements, the officers are prohibited from engaging in activities which are competitive with those of the Company during their employment with the Company and for one year following termination. If the agreement is terminated other than for cause, the officer would be entitled to any and all base salary earned through the date of termination, accrued but unused vacation, all vested equity, and bonus amounts payable to the officer through the date of termination. The officer would also be entitled to receive an additional thirty-six months of annual compensation equal to the average of his base salary and bonus for the three calendar years prior to the date of termination, payable in accordance with the Company's regular payroll practice over a 52-week period.

NOTE J– MAJOR CUSTOMERS

The Company had two customers who accounted for 12% and 13% of net sales for the six months ended May 31, 2016 and one customer who accounted for 27% of net sales for the six months ended May 31, 2015. The Company had no customers who accounted for 10% of accounts receivable at May 31, 2016 and one customer who accounted for 10% of accounts receivable at November 30, 2015.

NOTE K- MAJOR SUPPLIERS

During the six months ended May 31, 2016 and May 31, 2015 there was one foreign supplier accounting for 51% and 62% of total inventory purchased.

The Company purchases substantially all of its products overseas. For the six months ended May 31, 2016, the Company purchased 54% of its products from Taiwan, 15% from Hong Kong, 29% from elsewhere in Asia and less than 1% overseas outside of Asia. The Company purchases the balance of its products in the United States.

NOTE L - EXPORT SALES

The Company's export sales were as follows:

|                       | Six Months Ended |           |
|-----------------------|------------------|-----------|
|                       | May 31,          | May 31,   |
|                       | 2016             | 2015      |
| Canada                | 2,140,443        | 1,493,805 |
| China                 | 2,783,371        | 2,414,607 |
| Other Asian Countries | 411,617          | 573,083   |
| South America         | 150,220          | 215,084   |
| Europe                | 216,839          | 590,768   |

Revenues are attributed to countries based on location of customer.

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

The following discussion contains forward-looking statements. All statements other than statements of historical facts contained herein, including statements regarding our future results of operations and financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements.

In some cases, forward-looking statements can be identified by terms such as "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "target," "projects," "contemplates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other similar words. These statements are only predictions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. We discuss many of the risks in greater detail under the heading "Risk Factors" in our Annual Report on Form 10-K. Also, these forward-looking statements represent our estimates and assumptions only as of the date of the filing of this report. Except as required by law, we assume no obligation to update any forward-looking statements for events or circumstances occurring after the date of the filing of this report.

### **Overview**

The Company operates with two sales groups, Surge Components ("Surge") and Challenge Electronics ("Challenge"). Surge is a supplier of electronic products and components. These products include capacitors, which are electrical energy storage devices, and discrete semiconductor components, such as rectifiers, transistors and diodes, which are single function low power semiconductor products that are packaged alone as compared to integrated circuits such as microprocessors. The products sold by Surge are typically utilized in the electronic circuitry of diverse products, including, but not limited to, automobiles, audio products, temperature control products, lighting products, energy related products, computer related products, various types of consumer products, garage door openers, household appliances, power supplies and security equipment. These products are sold to both original equipment manufacturers, commonly referred to as OEMs, who incorporate them into their products, and to distributors of the lines of products we sell, who resell these products within their customer base. These products are manufactured predominantly in Asia by approximately sixteen independent manufacturers. We act as the master distribution agent utilizing independent sales representative organizations in North America to sell and market the products for one such manufacturer pursuant to a written agreement. When we act as a sales agent, our supplier who sold the product to the customer that we introduced to our supplier pays us a commission. The amount of the commission is determined on a sale by sale basis depending on the profit margin of the product. Commission revenue totaled \$177,963 and \$113,998 for the six months ended May 31, 2016 and May 31, 2015, respectively.

Challenge is engaged in the sale of electronic components. In 1999, Challenge began as a division to sell audible components. We have been able to increase the types of products that we sell because some of our suppliers introduced new products, and we also located other products from new suppliers. Our core products include buzzers, speakers, microphones, resonators, alarms, chimes, filters, and discriminators. We now also work with our suppliers to have our suppliers customize many of the products we sell for many customers through the customers' own designs and those that we work with our suppliers to have our suppliers redesign for them at our suppliers' factories. We have a design engineer on our staff with more than thirty years of experience with these types of products, who works with our suppliers on such redesigns. We are continually looking to expand the line of products that we sell. In 2015, we hired a junior engineer to assist with the introduction of a new micro controller product line. We sell these products through independent representatives that earn a commission on the products we sell. We are also working with local, regional, and national distributors to sell these products to local accounts in every state.



The Company has a Hong Kong office to effectively handle the transfer business from United States customers purchasing and manufacturing in Asia after designing the products in the United States. This office has strengthened the Company's global capabilities and services to its customer base.

The electronic components industry has changed from one of strong demand to one of reduced demand. This reduced demand can be attributed to a slowdown in global growth as well as a slowdown in the forecast of retail sales in North America. Management expects 2016 to continue with the reduced demand for components that the Company experienced in 2015. Due to this worldwide reduction in demand, the Company may be impacted by the effects of potentially reduced demand for its products throughout 2016.

In order to help increase sales, the Company hired 2 new salespersons and one new engineering employee during the six and three months ended May 31, 2016, which increased our salaries and related costs by approximately \$206,000 and \$117,000 for the six and three months ended May 31, 2016. While the Company incurred operational expenses for these employees during the six and three months ended May 31, 2016, the Company expects an increase in sales resulting from these new employees beginning in the first quarter of Fiscal 2017.

In order for us to grow, we will depend on, among other things, the continued growth of the electronics and semiconductor industries, our ability to withstand intense price competition, our ability to obtain new customers, our ability to retain and attract sales and other personnel in order to expand our marketing capabilities, our ability to secure adequate sources of products, which are in demand on commercially reasonable terms, our success in managing growth, including monitoring an expanded level of operations and controlling costs.

## **Critical Accounting Policies**

### *Accounts Receivable*

The allowance for doubtful accounts is based on the Company's assessment of the collectability of specific customer accounts and an assessment of international, political and economic risk as well as the aging of the accounts receivable. If there is a change in actual defaults from the Company's historical experience, the Company's estimates of recoverability of amounts due could be affected and the Company would adjust the allowance accordingly.

### *Revenue Recognition*

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed and determinable, collectability is reasonably assured and title and risk of loss have been transferred to the customer. This occurs when product is shipped from the Company's warehouse. For direct shipments from our suppliers to our customer, revenue is recognized when product is shipped from the Company's supplier. The Company acts as a sales agent for certain customers buying direct from one of its suppliers. The Company reports these commissions as revenues in the period earned.

The Company performs ongoing credit evaluations of its customers and maintains reserves for potential credit losses.

### *Inventory Valuation*

Inventories are recorded at the lower of cost or market. Write-downs of inventories to market value are based on stock rotation, historical sales requirements and obsolescence as well as in the changes in the backlog. Reserves required for obsolescence were not material in any of the periods in the financial statements presented. If market conditions are less favorable than those projected by management, additional write-downs of inventories could be required. For example, each additional 1% of obsolete inventory would reduce operating income by approximately \$35,000.

Because of the experience of the Company's management, including Ira Levy and Steven Lubman, the Company believes that it knows the best prices to buy the products it sells and as a result the Company generally waives rights to manufacturers' inventory protection agreements (including price protection and inventory return rights), and thereby bears the risk of increases in the prices charged by manufacturers and decreases in the prices of products held in the Company's inventory or covered by purchase commitments. If prices of components which the Company holds in inventory decline, or if new technology is developed that displaces products that the Company sells, the business could be materially adversely affected. These changes can potentially increase due to general economic conditions and customer-specific business conditions. If the Company's customers experience these changes, the business could be adversely affected.

### *Income Taxes*

We have made a number of estimates and assumptions relating to the reporting of a deferred income tax asset to prepare our financial statements in accordance with generally accepted accounting principles. These estimates have a significant impact on our valuation allowance relating to deferred income taxes. Our estimates could materially impact the financial statements.

### **Results of Operations**

Consolidated net sales for the six months ended May 31, 2016 decreased by \$682,437, or 4.8%, to \$13,396,453, as compared to net sales of \$14,078,890 for the six months ended May 31, 2015. Consolidated net sales for the three months ended May 31, 2016 decreased by \$38,823, or less than 1%, to \$7,080,442, as compared to net sales of \$7,119,265 for the three months ended May 31, 2015. We attribute the decrease to certain of the Company's customers experiencing a downturn in their business and to one of the Company's larger customers designing one new product model that does not include the Company's product in its design. We also attribute the decrease in net sales to a downward trend in market demand for our products due to adverse market conditions in China and Europe, reducing these customers demands for their products in these two markets. Even with this lower demand in the China consumer market, certain of our customers in China are doing well, resulting in an increase in sales to China for the six months ended May 31, 2016. The Company expects these market conditions to continue through the fourth quarter of 2016.

Our gross profit for the six months ended May 31, 2016 decreased by \$414,039 to \$3,291,862, or 11.2%, as compared to \$3,705,901 for the six months ended May 31, 2015. Gross margin as a percentage of net sales decreased to 24.6% for the six months ended May 31, 2016 compared to 26.3% for the six months ended May 31, 2015. Gross profit for the three months ended May 31, 2016 decreased by \$225,091 to \$1,635,850, or 12.1%, as compared to \$1,860,941 for the three months ended May 31, 2015. Gross margin as a percentage of net sales decreased to 23.1% for the three months ended May 31, 2016 compared to 26.1% for the three months ended May 31, 2015. The Company attributes the decrease in gross profit to the decrease in sales volume as well as the mix of products sold to certain customers in the six and three months ended May 31, 2016. Profit margins have also been negatively impacted because of a return of inventory by one of our distributor customers, resulting in an increase in our reserve for obsolete inventory. While this practice is allowed under the terms of our contract with the distributor, it has been used infrequently. Profit margins have also been impacted as a result of certain of our customers, who are some of the biggest buyers of components, demanding the lowest prices for our products. Some of them further demand periodic price reductions on a quarterly or semi-annual basis, as opposed to annual fixed pricing. We work with electronic manufacturing service subcontractor customers who manufacture products for other customers who do not have their own manufacturing operations. At times we are not able to recover these price reductions from our suppliers. The Company has agreements with these subcontractor customers to provide periodic cost reductions through rebates in the amount of 5%. These reductions only affect future shipments of our products, and does not affect existing orders. These reductions can have a negative impact on our profit margins since it reduces the amount of commissions we can earn. Even though this rebate can impact the Company's gross profit margin, these subcontractor customers represent very

significant potential growth for the Company, because they help the Company become an approved supplier at the customers they manufacture for, and they purchase our components for these customers. It would be very difficult for the Company to achieve business at these customers without the help of these subcontractor customers.

Selling and shipping expenses for the six months ended May 31, 2016 was \$1,191,146, an increase of \$24,076, or 2.1%, as compared to \$1,167,070 for the six months ended May 31, 2015. Selling and shipping expenses for the three months ended May 31, 2016 was \$665,300, an increase of \$47,792, or 7.7%, as compared to \$617,508 for the three months ended May 31, 2015. We attribute the increase to hiring additional salespeople to grow the business, travel and entertainment expenses and auto expenses and partially offset by decreases in commission expenses, advertising, freight out and shipping expenses.

General and administrative expenses for the six months ended May 31, 2016 was \$2,088,975, an increase of \$126,503, or 6.4%, as compared to \$1,962,472 for the six months ended May 31, 2015. General and administrative expenses for the three months ended May 31, 2016 was \$1,090,073, an increase of \$132,331, or 13.8%, as compared to \$957,742 for the three months ended May 31, 2015. We attribute the increase to the hiring of additional employees to grow the business and increased costs of both health and general insurance, promotional expenses, consulting and rent expenses, stock compensation and public company expenses and partially offset by decreases in professional fees and utilities expenses.

Depreciation expense for the six months ended May 31, 2016 was \$15,632, a decrease of \$1,848 or 10.6%, as compared to \$17,480, for the six months ended May 31, 2015. Depreciation expense for the three months ended May 31, 2016 was \$7,816, a decrease of \$1,141, or 12.7%, as compared to \$8,957 for the three months ended May 31, 2015. We attribute the decrease to certain assets becoming fully depreciated during the fiscal year ended November 30, 2015.

Investment income for the six months ended May 31, 2016 was \$4,083, a decrease of \$222 or 5.2%, compared to \$4,305 for the six months ended May 31, 2015. Investment income for the three months ended May 31, 2016 was \$2,758, an increase of \$450, or 19.5%, compared to \$2,308 for the three months ended May 31, 2015. We attribute the decrease to lower interest rates in the Company's money market accounts during the six months ended May 31, 2016. The Company moved certain money market accounts to higher interest rate accounts in the second quarter resulting in the increase in investment income during the three months ended May 31, 2016.

Income taxes for the six months ended May 31, 2016 was \$13,520, a decrease of \$126,663, or 90.4% as compared to income taxes of \$140,183 for the six months ended May 31, 2015. Income taxes for the three months ended May 31, 2016 was \$16,782, a decrease of \$73,140 or 129.8%, as compared to income taxes of \$56,358 for the three months ended May 31, 2015. The decrease is a result of a net loss during the six months ended May 31, 2016 and the related reduction in estimated federal and state taxes based on income as well as management's revised estimate of future taxable income and the related impact on the reported deferred tax. This change in the valuation allowance is based on management's estimates of future taxable income. The degree of variability inherent in the estimates of future taxable income is significant and subject to change in the near term. The Company reviews its estimates of future taxable income in each reporting period and adjustments to the valuation allowance are reflected in the current operations.

As a result of the foregoing, net loss for the six months ended May 31, 2016 was \$(13,328), compared to net income of \$423,001 for the six months ended May 31, 2015. The net loss for the three months ended May 31, 2016 was \$(107,799), compared to net income of \$222,684 for the three months ended May 31, 2015.

### **Liquidity and Capital Resources**

As of May 31, 2016 we had cash of \$7,234,406, and working capital of \$11,226,276. We believe that our working capital levels are adequate to meet our operating requirements during the next twelve months.

During the six months ended May 31, 2016, we had net cash flow provided by operating activities of \$69,096, as compared to net cash flow provided by operating activities of \$575,811 for the six months ended May 31, 2015. We attribute the decrease in cash flow provided by operating activities to decreases in net income, prepaid expenses and accounts payable and changes in inventory, and deferred income taxes as partially offset by decreases in accrued expenses and increases in accounts receivable.

We had net cash flow used in investing activities of \$(1,520) for the six months ended May 31, 2016, as compared to net cash flow used in investing activities of \$(54,826) for the six months ended May 31, 2015. We attribute the decrease in net cash flow used in operating activities to the Company purchasing less new equipment during the six months ended May 31, 2016.

We had net cash flow used in financing activities of \$(2,287) for the six months ended May 31, 2016, as compared to net cash flow provided by financing activities of \$143,750 for the six months ended May 31, 2015. We attribute the decrease to the exercise of stock options to acquire 575,000 shares of common stock in the six months ended May 31, 2015.

As a result of the foregoing, the Company had a net increase in cash of \$65,288 for the six months ended May 31, 2016, as compared to a net increase in cash of \$664,735 for the six months ended May 31, 2015.

We will continue to evaluate opportunities to use any excess cash generated by our operations, including investing in acquisitions, expanding our business by hiring new salespeople and other employees to help grow the business and repurchasing our common stock while maintaining sufficient liquidity to support our operational needs and fund future strategic growth opportunities. In November 2015, our board of directors authorized a program to repurchase up to \$500,000 of our common stock. Pursuant to such authority and pursuant to Rule 10b-18 under the Exchange Act, we repurchased a total of 2,823 shares for \$2,255 during the three months ended May 31, 2016

The table below sets forth our contractual obligations, including long-term debt, operating leases and other long-term obligations, as of May 31, 2016:

| Contractual Obligations | Total     | Payments due     |                   |                   |                        |
|-------------------------|-----------|------------------|-------------------|-------------------|------------------------|
|                         |           | 0 – 12<br>Months | 13 – 36<br>Months | 37 – 60<br>Months | More than<br>60 Months |
| Long-term debt          | \$-       | \$-              | \$-               | \$-               | \$-                    |
| Operating leases        | \$669,489 | 236,247          | 371,181           | 62,061            | -                      |
| Total obligations       | \$669,489 | \$236,247        | \$371,181         | \$62,061          | \$-                    |

### **Inflation**

In the past two fiscal years, inflation has not had a significant impact on our business. However, any significant increase in inflation and interest rates could have a significant effect on the economy in general and, thereby, could affect our future operating results.

### **Off Balance Sheet Arrangements**

We do not have any off balance sheet arrangements.

**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 controls and procedures designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (“Exchange Act”), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (“Commission”). Ira Levy, the Company’s principal executive officer and principal financial officer has evaluated the effectiveness of the Company’s disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of May 31, 2016 and has concluded that, as of such date, our disclosure controls and procedures were effective.

**Changes in Internal Controls**

During the three months ended May 31, 2016, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS.**

There are no legal proceedings to which the Company or any of its property is the subject.

**ITEM 1A. RISK FACTORS.**

Not applicable.

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

Share repurchase activity during the three months ended May 31, 2016 was as follows:

| <b>Periods</b>                                  | <b>Total<br/>Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price<br/>Paid Per<br/>Share</b> | <b>Total<br/>Number<br/>of Shares<br/>Purchased<br/>as Part of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>Approximate<br/>Dollar<br/>Value of<br/>Shares That<br/>May Yet Be<br/>Purchased<br/>Under the<br/>Plans or<br/>Programs<sup>(1)</sup></b> |
|---|---|---|---|---|
| March<br>1, 2016<br>to<br>March<br>31,<br>2016: | -   | -   | -   | \$ 500,000  |
|   | 800   | \$0.76  | 800   | \$ 499,392  |



|  |       |         |       |            |
|--|-------|---------|-------|------------|
| April 1,<br>2016 to<br>April<br>30,<br>2016: |       |         |       |            |
| May 1,<br>2016 to<br>May<br>31,<br>2016:     | 2,023 | \$0.814 | 2,023 | \$ 497,745 |
| Total  |       |         |       | \$ 497,745 |

In November 2015, the Company's Board of Directors authorized a program to repurchase up to \$500,000 of the Company's common stock. The Company's share repurchase program does not obligate it to acquire any specific (1) number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions pursuant to Rule 10b-18 under the Exchange Act, including under plans complying with Rule 10b5-1 under the Exchange Act.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None.

**ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable

**ITEM 5. OTHER INFORMATION.**

None.

**ITEM 6. EXHIBITS.**

| <b>Exhibit Number</b> | <b>Description</b>  |
|-----------------------|---|
| 31.1                  | <u>Certification by principal executive officer and principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> |
| 32.1                  | Certification by principal executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002        |
| 101.INS               | XBRL Instance Document  |
| 101.SCH               | XBRL Taxonomy Extension Schema Document   |
| 101.CAL               | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF               | XBRL Taxonomy Extension Definition Linkbase Document  |
| 101.LAB               | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE               | XBRL Taxonomy Extension Presentation Linkbase Document  |

**SIGNATURES**

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

**SURGE COMPONENTS, INC.**

Date: July 15, 2016 By: /s/ Ira Levy

Name: Ira Levy

Chief Executive Officer

Title: (Principal Executive Officer,  
Principal Financial Officer and  
Principal Accounting Officer)