SURGE COMPONENTS INC
Form 10-Q
July 16, 2018

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, 2018

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 (Address of principal executive offices)	**11729** (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 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 emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer, “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

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 July 13, 2018 the registrant had 5,224,431 shares of common stock, $.001 par value, outstanding.

SURGE COMPONENTS, INC

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	May 31, 2018 (unaudited)	November 30, 2017
ASSETS		
Current assets:		
Cash	$ 1,307,144	$ 1,086,999
Accounts receivable - net of allowance for doubtful accounts of $161,560	5,205,771	5,933,268
Inventory, net	3,803,949	3,161,587
Prepaid expenses and income taxes	178,402	158,869
Total current assets	10,495,266	10,340,723
Fixed assets – net of accumulated depreciation and amortization of $2,242,140 and $2,217,654	140,481	138,329
Deferred income taxes	963,061	982,880
Other assets	13,384	13,384
Total assets	$ 11,612,192	$ 11,475,316

See notes to consolidated financial statements

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(Continued)

	May 31, 2018 (unaudited)	November 30, 2017
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$5,063,057	$4,629,932
Loan Payable	225,000	500,000
Capital Lease Payable, Current maturities	6,180	6,411
Accrued expenses and taxes	909,420	937,249
Accrued salaries	434,995	621,930
Total current liabilities	6,638,652	6,695,522
Capital lease payable, net of current maturities	29,100	32,536
Deferred rent	30,334	34,518
Total liabilities	6,698,086	6,762,576
Commitments and contingencies		
Shareholders' equity:		
Preferred stock - $.001 par value, 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
Series D – 75,000 shares authorized, none issued or outstanding, voting, convertible, redeemable.		
Common stock - $.001 par value, 75,000,000 shares authorized, 5,224,431 and 5,224,431 shares issued and outstanding	5,224	5,224
Additional paid-in capital	16,557,310	16,557,310
Accumulated deficit	(11,648,438)	(11,849,804)
Total shareholders' equity	4,914,106	4,712,740
Total liabilities and shareholders' equity	$11,612,192	$11,475,316

See notes to consolidated financial statements.

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SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

(Unaudited)

	Six Months Ended May 31,		Three Months Ended May 31,	
	2018	2017	2018	2017
Net sales	$14,244,425	$13,098,312	$7,262,098	$7,433,165
Cost of goods sold	10,510,664	9,895,478	5,342,011	5,639,684
Gross profit	3,733,761	3,202,834	1,920,087	1,793,481
Operating expenses:				
Selling and shipping expenses	1,255,839	1,220,974	637,418	660,198
General and administrative expenses	2,193,165	2,544,859	1,095,209	1,215,796
Depreciation and amortization	24,486	15,765	12,532	7,931
Total operating expenses	3,473,490	3,781,598	1,745,159	1,883,925
Income (loss) before other income (expense) and income taxes	260,271	(578,764)	174,928	(90,444)
Other income (expense):				
Investment income	2	3,105	1	137
Interest expense	(9,734)	(6,815)	(3,713)	(6,815)
Other income (expense)	(9,732)	(3,710)	(3,712)	(6,678)
Income (loss) before income taxes	250,539	(582,474)	171,216	(97,122)
Income taxes (benefit)	46,673	(128,967)	2,907	6,212
Net income (loss)	203,866	(453,507)	168,309	(103,334)
Dividends on preferred stock	2,500	2,500	-	-
Net income (loss) available to common shareholders	$201,366	$(456,007)	$168,309	$(103,334)
Net income (loss) per share available to common shareholders:				

Basic	$.04	$(.06)	$.03	$(.02)
Diluted	$.04	$(.06)	$.03	$(.02)
Weighted Shares Outstanding:				
Basic	5,224,431	7,779,376	5,224,431	5,387,474
Diluted	5,358,768	7,779,376	5,358,768	5,387,474

See notes to consolidated financial statements.

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SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended	
	May 31, 2018	May 31, 2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income (Loss)	$203,866	$(453,507)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	24,486	15,765
Deferred income taxes	19,819	(145,271)
Allowance for doubtful accounts	-	919
CHANGES IN OPERATING ASSETS AND LIABILITIES:		
Accounts receivable	727,497	473,700
Inventory	(642,362)	(111,809)
Prepaid expenses and income taxes	(19,533)	(1,922)
Accounts payable	433,125	564,954
Deferred rent	(4,184)	(2,429)
Accrued expenses	(217,264)	(515,777)
NET CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES	525,450	(175,377)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of fixed assets	(30,305)	(14,858)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	$(30,305)	$(14,858)

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

(Continued)

	Six Months Ended May 31, 2018	Six Months Ended May 31, 2017
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net Borrowings from loan payable	$(275,000)	$800,000
Repurchase of Common Stock in Tender Offer	-	(7,150,000)
NET CASH FLOWS USED IN FINANCING ACTIVITIES	(275,000)	(6,350,000)
NET CHANGE IN CASH	220,145	(6,540,235)
CASH AT BEGINNING OF PERIOD	1,086,999	7,120,601
CASH AT END OF PERIOD	$1,307,144	$580,366
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Income taxes paid	$15,079	$9,611
Interest paid	$9,734	$6,815
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Accrued dividends on preferred stock	$2,500	$2,500

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 and 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, 2018 and May 31, 2017 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 amounts 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:

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers: Topic 606." This ASU replaces nearly all existing U.S. generally accepted accounting principles guidance on revenue recognition. The standard prescribes a five-step model for recognizing revenue, the application of which will require significant judgment by the Company. The Company adopted the standard using the modified retrospective approach in its fiscal year beginning December 1, 2017. The preponderance of the Company's contracts with customers are standard ship and bill arrangements where revenue is recognized at the time of shipment. Adoption of this ASU did not have a significant impact on the Company's consolidated financial position, results of operations or cash flows.

Revenue is recognized at the point at which control of the underlying goods or services are transferred to the customer, which included determining whether goods and services are distinct and separate performance obligations, which may require significant judgment. Satisfaction of the Company's performance obligations occur upon the transfer of control of goods or services, either from the Company's facilities or directly from suppliers to customers. The Company considers customer purchase orders, which in some cases are governed by master agreements, to be the contracts with a customer. Substantially all revenue is generated from contracts with customers.

In determining the transaction price, the Company evaluates whether the price is subject to refund or adjustment to determine the net consideration to which the Company expects to receive. The amount of consideration received and revenue recognized by the Company vary due to contractually defined incentives and return rights that are held by customers. These adjustments are made in the same period as the underlying transactions.

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 $2,266,000 and $1,363,000 for the six months ended May 31, 2018 and May 31, 2017, respectively.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(3) Revenue Recognition (continued):

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 they are earned. Commission revenue totaled $77,288 and $81,775 for the six months ended May 31, 2018 and May 31, 2017, respectively.

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

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 $1,966,000 and $2,307,000 for six months ended May 31, 2018 and May 31, 2017, 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, 2018 was $2,041,698. The Company, at May 31, 2018, has a reserve against slow moving and obsolete inventory of $269,604. 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.

(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, 2018 and November 30, 2017, the Company's uninsured cash balances totaled $742,844 and $522,504, 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 J.

As of December 1, 2017, the Company adopted ASU No. 2015-17, "Balance Sheet Classification of Deferred Taxes". Pursuant to the ASU, all deferred taxes are reported as non-current assets or liabilities. The Company has applied the ASU on a retrospective basis. The effect of the change for the period ended November 30, 2017 was to decrease current assets by $327,627 and increase non-current assets by $327,627.

The Company follows the provisions of the Accounting Standards Codification ("ASC") topic 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 year ended November 30, 2013, and state tax examinations for years before fiscal year ended November 30, 2012. Management does not believe there will be any material changes in the Company’s 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, 2018 and May 31, 2017.

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.

(12) Shipping Costs

The Company classifies shipping costs as a component of selling expenses. Shipping costs totaled $4,013 and $4,421 for the six months ended May 31, 2018 and May 31, 2017, respectively.

(13) Income Per Share

Basic income (loss) 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. Total potentially dilutive shares excluded from diluted weighted shares outstanding at May 31, 2018 and May 31, 2017 totaled 215,663 and 452,000, respectively.

(14) Stock Based Compensation

Stock Based Compensation to Employees

The Company accounts for its stock-based compensation for employees in accordance with ASC 718. The Company recognizes in its consolidated statements 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.

(15) Recently Issued Standards

In February 2016, FASB issued ASU No. 2016-02, “Leases.” This ASU requires all lessees to be recognized on the balance sheet as right to use assets and lease liabilities for the rights and obligations created by lease arrangements with terms greater than 12 months. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018 and for interim periods therein. The Company is in the process of assessing the impact the adoption of this ASU will have on its consolidated financial position, results of operations and cash flows. At a minimum, total assets and total liabilities will increase in the period the ASU is adopted. Early adoption of this ASU is permitted. At May 31, 2018, the Company’s undiscounted future minimum payments outstanding for lease obligations (including those currently included as capital lease obligations) were approximately $472,000.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE C – FIXED ASSETS

Fixed assets consist of the following:

	May 31, 2018	November 30, 2017
Furniture and Fixtures	$ 327,971	$ 327,971
Leasehold Improvements	991,646	987,137
Computer Equipment	1,063,004	1,040,875
Less-Accumulated Depreciation	(2,242,140)	(2,217,654)
Net Fixed Assets	$ 140,481	$ 138,329

Depreciation and amortization expense for the six months ended May 31, 2018 and May 31, 2017was $24,486 and $15,765, respectively.

NOTE D – CAPITALIZED LEASE OBLIGATIONS

The Company is obligated under capitalized leases for telephone equipment. The Company leases equipment under two capital lease arrangements. Pursuant to the leases, the lessor retains actual title to the leased property until the termination of the lease, at which time the equipment can be purchased for one dollar for each lease. The terms of the leases are 60 months with a combined monthly payment of $815, respectively. The assumed interest rates on the leases are 9.342% per annum. The leases terminate in 2022.

Future minimum lease payments under these capitalized lease obligations as of May 31, 2018 are as follows:

2019	$9,779
2020	$9,779
2021	$9,779
2022	$9,779
2023	$4,892
Total	$44,008
Less: interest portion	8,728
Present value of net minimum lease payments	$35,280
Less: current portion	6,180
Non-current portion	$29,100

Capital lease obligations mature as follows:

Twelve months ending May 31:	
2019	$6,180
2020	$7,371
2021	$8,090
2022	$8,879
2023	$4,760
Principal payments remaining	$35,280

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE E – LINE OF CREDIT

In February 2017, the Company obtained a line of credit with a bank for up to $3,000,000 (the “Credit Line”). Borrowings under the Credit Line are due upon demand and accrue interest at the greater of the prime rate or the LIBOR rate plus two percent (and may be increased by three percent in the event the Company fails to (i) repay all amounts due on the Credit Line upon demand or (ii) comply with any terms or conditions relating to the Credit Line). As of May 31, 2018, the balance on the Credit Line was $225,000. As of May 31, 2018, the Company was in compliance with the covenant for the debt service coverage ratio for the Credit Line.

NOTE F – ACCRUED EXPENSES

Accrued expenses consist of the following:

	May 31, 2018	November 30, 2017
Commissions	$177,919	$ 186,282
Preferred Stock Dividends	139,069	136,569
Other accrued expenses	149,341	158,928
Accrued Professional Fees	443,091	455,470
	$909,420	$ 937,249

NOTE G – 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 $1,432,000 at November 30, 2017. Pension expense for the six months ended May 31, 2018 and May 31, 2017 was $590 and $360, respectively.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE H – 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"). None of the Series A preferred stock is outstanding as of May 31, 2018.

In November 2000, the Company authorized 200,000 shares of preferred stock as Voting Redeemable Convertible Series B Preferred Stock ("Series B Preferred"). None of the Series B Preferred Stock is outstanding as of May 31, 2018.

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 $139,069 have not been paid for the semi-annual periods ended December 31, 2001 through the semi-annual payment due December 31, 2018. The Company has accrued these dividends. At May 31, 2018, there are 10,000 shares of Series C Preferred issued and outstanding.

In October 2016, the Company authorized 75,000 shares of preferred stock as Voting Non-Redeemable Convertible Series D Preferred Stock (“Series D Preferred”). None of the Series D Preferred Stock is outstanding as of May 31, 2018.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE H – 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 year ended May 31, 2018 is summarized as follows:

	Shares	Weighted Average Exercise Price
Options outstanding December 1, 2017	250,000	$ 0.94
Options issued in the six months ended May 31, 2018	-	$ -
Options exercised in the six months ended May 31, 2018	-	$ -
Options cancelled in the six months ended May 31, 2018	-	$ -
Options outstanding at May 31, 2018	250,000	$ 0.94
Options exercisable at May 31, 2018	250,000	$ 0.94

[3] 2015 Incentive Stock Plan

In November 2015, the Company adopted and the shareholders ratified, the 2015 Incentive Stock Plan ("2015 Stock Plan"). The 2015 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.

In May 2016, a total of 99,151 shares were issued to the Company's officers as part of their 2015 bonus compensation under the 2015 Stock Plan.

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 under the 2015 Stock Plan as part of their 2015 bonus. The Company recorded a cost of $74,363 relating to the issuance of these shares.

In October 2016 one employee director exercised options to acquire 50,000 shares of common stock at $0.82 per share and 62,500 shares of common stock at $0.80 per share. In October 2016, one employee director exercised options to acquire 25,000 shares of common stock at $0.82 per share and 45,938 shares of common stock at $0.80 per share.

The intrinsic value of the exercisable options at May 31, 2018 totaled $102,750. At May 31, 2018, the weighted average remaining life of the stock options is 1.81 years. At May 31, 2018, there was no unrecognized compensation cost related to the stock options granted under the plan.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE H – SHAREHOLDERS' EQUITY (Continued)

[4] Authorized Repurchase of Shares:

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"), a total of 57,283 shares were repurchased by the Company for approximately $48,300. In January 2017, the Company terminated its repurchase program.

In March 2017, the Company completed a tender offer whereby it purchased for cash 5,000,000 shares of its common stock, at a price of $1.43 per share, or $7,150,000.

[5] Compensation of Directors

Compensation for each non-employee director is $2,500 per month (and $3,500 per month for a non-employee director that serves as the chairman of more than two committees of the Board of Directors).

NOTE I – SETTLEMENT AGREEMENT

On or about October 31, 2016, Michael D. Tofias and Bradley P. Rexroad (collectively, the "Stockholders") filed a Complaint and Motion for Preliminary Injunction against the Company in the eighth Judicial District Court, Clark County, Nevada, Case No. A-16-745890-B, seeking relief including, inter alia, immediate inspection of certain books and records and a 60-day postponement of the scheduled annual meeting of stockholders ("Annual Meeting"). On November 16, 2016, after the Company postponed the Annual Meeting and provided certain books and records to the Stockholders, the Stockholders filed an Amended Complaint, which named all members of the Board as defendants and alleged that the directors had breached their fiduciary duty to the Stockholders. On December 1, 2016, following a hearing, the Court denied the request for a preliminary injunction. On December 22, 2016, the Company entered into a settlement agreement (the "Settlement Agreement") with the Stockholders.

The Settlement Agreement provides that:

the Stockholders irrevocably withdraw their director nominations for the Board and stockholder proposals for the Company's annual meeting of stockholders for fiscal year 2015 (the "Meeting");

the Stockholders will vote all of their shares of common stock of the Company in accordance with the Board's recommendations with respect to the election of the Board's director nominees, the ratification of the Company's independent registered public accounting firm for the fiscal year ending November 30, 2016 (the "2017 Meeting") and the ratification of the Company's rights plan;

the Company will hold the Meeting on January 5, 2017 and will hold its annual meeting of stockholders for fiscal year 2016 by December 29, 2017;

the Board and the Stockholders will identify a mutually acceptable independent director to join the Board as a Class C director by February 28, 2017 and the Board will include that new director among its director nominees for the 2017 Meeting;

the Company will not make any stock or option grants or grant any other non-cash compensation to its current officers and directors until December 23, 2017;

the Company will take all steps to (i) change its state of incorporation from the State of Nevada to the State of Delaware and (ii) declassify the Board on a rolling basis by June 30, 2017, and the Company will convene a special meeting of stockholders of the Company for the purpose of approving such actions, at which meeting the Stockholders and the Insiders will vote all of their shares of common stock of the Company in favor of such actions;

The Company will commence an issuer tender offer to all of its stockholders to repurchase at least 5,000,000 shares of its common stock at price of $1.43 per share (the "Tender Offer"), which Tender Offer will be completed by March 15, 2017.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE I – SETTLEMENT AGREEMENT (Continued)

until the day after the announcement of the completion of the Tender Offer, the Board will be composed of no more than seven individuals;

the Stockholders will tender all of the shares of common stock of the Company that they hold beneficially or of record in the Tender Offer, subject to limited exceptions;

the Company's officers and directors will not participate in the Tender Offer and will not transfer or sell any of their shares until six months after the Tender Offer is completed;

subject to certain conditions, if the Tender Offer is not completed by March 15, 2017, the Company will (i) appoint the Stockholders to the Board as Class A directors with terms expiring at the Company's annual meeting of stockholders for fiscal year 2018 (the "2019 Meeting") and (ii) reduce the size of the Board to six directors, including the Stockholders;

the Stockholders will withdraw with prejudice their lawsuit against the Company and the Insiders pending in the State of Nevada; and

the Stockholders will be subject to customary standstill provisions until the termination of the Settlement Agreement.

Pursuant to the Settlement Agreement, the Company also agreed to reimburse the expenses of the Stockholders associated with their investment in the Company, including their proxy solicitation and litigation costs, in an amount not to exceed $300,000.

The Settlement Agreement terminates on the date that is 15 business days prior to the deadline for the submission of director nomination and stockholder proposals for the 2019 Meeting.

NOTE J – 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, 2018	November 30, 2017
Deferred Tax Assets		
Net operating loss	$3,978,998	$4,053,847
Allowance for bad debts	49,909	49,909
Inventory	69,961	28,854
Deferred Rent	12,116	13,786
Depreciation	118,748	148,569
Total deferred tax assets	4,229,732	4,294,965
Valuation allowance	(3,266,671)	(3,312,085)
Deferred Tax Assets	$963,061	$982,880

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 $45,000 during the six months ended May 31, 2018. 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.

As a result of the Tax Costs and Jobs Act, the maximum federal tax rate was reduced to 21% and certain provisions to alternative minimum taxes were amended which affect the Company's ability to utilize its net operating losses against future earnings. The effect of the decrease in the tax rate is to reduce the potential tax benefit by approximately 30%. The elimination of the alternative minimum tax will allow the Company to utilize more of its net operating losses in future years coupled with managements changes to the estimates for future taxable income substantially offset the reduction in the tax benefit for the change in tax rate.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE J – INCOME TAXES (Continued)

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

	Six Months Ended May 31, 2018	May 31, 2017
Current:		
Federal	$3,331	$-
States	18,111	16,304
	21,442	16,304
Deferred:		
Federal	21,283	(121,989)
States	3,948	(23,282)
	25,231	(145,271)
Provision for income taxes	$46,673	$(128,967)

The Company files a consolidated income tax return with its wholly-owned subsidiaries and has net operating loss carryforwards of approximately $9,423,000 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, 2018	May 31, 2017
U.S Federal Income tax statutory rate	21%	(34)%

Valuation allowance	(9)%	15 %
State income taxes	7 %	(3)%
Other	-	-
Effective tax rate	19%	(22)%

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SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE K – 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 $176,000 for the year ended November 30, 2017, 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 and is currently in negotiations to renew the lease. Annual minimum rental payments for this space are approximately $58,500.

The Company's future minimum rental commitments at May 31, 2018 are as follows:

Twelve Months Ended May 31,

2019	$181,341
2020	$184,968
2021	$62,062
	$428,371

Net rental expense for the six months ended May 31, 2018 and May 31, 2017 were $158,531 and $156,069, respectively, of which $129,822 and $128,068 respectively, was paid to the Related Company.

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SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE L – 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 may award these officers with bonuses and 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 employment 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 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 officers 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 M – MAJOR CUSTOMERS

The Company had two customers who accounted for 10% and 12% of net sales for six months ended May 31, 2018 and one customer who accounted for 12% of net sales for the six months ended May 31, 2017. The Company had two customers who accounted for 12 % and 13% of accounts receivable at May 31, 2018 and one customer who accounted for 11% of accounts receivable at November 30, 2017.

NOTE N – MAJOR SUPPLIERS

During the six months ended May 31, 2018 and May 31, 2017 there was one foreign supplier accounting for 57% and 51% of total inventory purchased.

The Company purchases substantially all of its products overseas. For the six months ended May 31, 2018, the Company purchased 53% of its products from Taiwan, 16% from Hong Kong, 27% 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 O – EXPORT SALES

The Company's export sales were as follows:

	Six Months Ended	
	May 31, 2018	May 31, 2017
Canada	$1,795,417	$1,808,713
China	$2,038,705	$2,083,166
Other Asian Countries	$730,150	$715,679
South America	$231,893	$205,631
Europe	$124,517	$668,538

Revenues are attributed to countries based on location of customer.

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

This report 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 “conti 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 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 $17,919 and $116,524 for the six months ended May 31, 2018 and May 31, 2017, respectively.

Challenge is engaged in the sale of electronic components. Challenge began as a division to sell audible components and 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 an engineer on our staff who works with our suppliers on such redesigns and assists with the introduction of new product lines. We are continually looking to expand the line of products that we sell. 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 position, improving our capabilities and service to our customer base.

The electronic components industry continues to change, and at this time there is a shortage of certain electronic components in the markets that the Company serves, which is expected to continue through 2018. The Company believes that this may be a potential opportunity for the Company to achieve business from new customers who are seeking alternative suppliers. However, certain customers are having trouble finding other components to fill their assemblies which has slowed down their production. Conversely, as our factory lead time has extended, we are now offering less benefits to customers as we had previously done.

The world of business is constantly changing because of "disruptors," which are significant changes in traditional business practices, that did not previously exist. For example, customers are moving to centralized purchasing from regional purchasing and are stretching their payment terms. These changes also include customers moving their manufacturing operations from North America to Asia, and the trend of globalization. This trend makes business more complicated and costly for the Company. The Company must have a presence in Asia to service and further develop the business. For these reasons, we established Surge Ltd., our Asia subsidiary. Currency fluctuations also have an effect on doing business outside of North America. Customers have moved to reduce their supply chain, which could adversely affect the Company. In some market segments, demand for electronic components have decreased, and in other segments, the demand is still strong. Some technologies have become obsolete, while customers develop new products using different kinds of components. Management expects the remainder of 2018 to continue to be a year of change and challenge, with this environment expected to continue into 2019. These challenges could affect the Company in negative ways, possibly reducing sales and or profitability. In order for the Company 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 key 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 executing and managing growth, including monitoring an expanded level of operations and systems, controlling costs, the availability of adequate financing, and our ability to deal successfully, with new and future disruptors. Another aspect of the electronics industry that has caused disruption and stress is the extended lead time for products in certain categories. Because of this extended lead time, the time from approval to shipping to customers is longer, which may prevent us from increasing our business as quickly as we had done previously.

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The Company is concerned about the impact of tariffs being considered by the United States to impose on Chinese goods being imported into the United States, which includes the Company's products. The imposition of such tariffs will likely cause our costs, as well as the prices we charge customers, to increase. However, there is no assurance that our customers will accept such increased prices. While the Company is investigating ways to reduce or avoid the tariffs, including shipping components from Asia directly to our customers' manufacturing facilities in Mexico and Canada or to their bonded inventory warehouses on the border, these tariffs could have a negative impact on the Company's business.

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 at the point at which control of the underlying goods or services are transferred to the customer, which included determining whether goods and services are distinct and separate performance obligations, which may require significant judgment. Satisfaction of the Company's performance obligations occur upon the transfer of control of goods or services, either from the Company's facilities or directly from suppliers to customers. The Company considers customer purchase orders, which in some cases are governed by master agreements, to be the contracts with a customer. Substantially all revenue is generated from contracts with customers.

In determining the transaction price, the Company evaluates whether the price is subject to refund or adjustment to determine the net consideration to which the Company expects to receive. The amount of consideration received and revenue recognized by the Company vary due to contractually defined incentives and return rights that are held by customers. These adjustments are made in the same period as the underlying transactions.

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 $41,000.

The Company does not have price protection agreements with any of its vendors and assumes the risk of changes in the prices of its products. The Company does not believe there to be a significant risk with regards to the lack of price protection agreements as many of its inventory items are purchased to fulfill purchase orders received.

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, 2018 increased by $1,146,113 or 8.8%, to $14,244,425 as compared to net sales of $13,098,312 for the six months ended May 31, 2017. Consolidated net sales for the three months ended May 31, 2018 decreased by $171,067 or 2.3%, to $7,262,098, as compared to net sales of $7,433,165 for the three months ended May 31, 2017. We attribute the increase in sales for the six months ended May 31, 2018 to an increase in business with new customers as well as additional business with existing customers. We attribute the decrease in sales for the three months ended May 31, 2018 to a decrease in business with some existing customers as well as certain customers' production slowing down because they are unable to find sufficient components to complete their assemblies. A portion of the decline was also due to a decrease in commission income resulting from the decrease in the percentage earned for certain customers.

Our gross profit for the six months ended May 31, 2018 increased by $530,927 to $3,733,761, or 16.6%, as compared to $3,202,834 for the six months ended May 31, 2017. Gross margin as a percentage of net sales increased to 26.2% for the six months ended May 31, 2018 compared to 24.5% for the six months ended May 31, 2017. Gross profit for the three months ended May 31, 2018 increased by $126,606 to $1,920,087, or 7.1%, as compared to $1,793,481 for the three months ended May 31, 2017. Gross margin as a percentage of net sales increased to 26.4% for the three months ended May 31, 2018 compared to 24.1% for the three months ended May 31, 2017. We attribute the increases in gross profit and gross profit margin as a percentage of net sales mostly to increased sales to existing customers and sales to existing customers with a higher profit margin in the six and three months ended May 31, 2018. Profit margins in 2017 and 2018 have 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. Our industry will continue to receive pressure from customers for price reductions. 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 do not affect existing orders. These reductions can have a negative impact on our profit margins since they reduce 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 can help the Company become an approved supplier at the customers they manufacture for, and they purchase our components for these customers. We believe 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, 2018 was $1,255,839, an increase of $34,865, or 2.9%, as compared to $1,220,974 for the six months ended May 31, 2017. Selling and shipping expenses for the three months ended May 31, 2018 was $637,418, a decrease of $22,780, or 3.5%, as compared to $660,198 for the three months ended May 31, 2017. We attribute the increase for the six months ended May 31, 2018 to increased commission expense relating to the increase in revenue, as well as increases in selling expenses such as entertainment and auto expenses, offset by a decrease in salesman compensation and travel expenses.. We attribute the decrease for the three months ending May 31, 2018 to decreases in commission expense, travel and shipping expenses offset by increases in entertainment expenses.

General and administrative expenses for the six months ended May 31, 2018 was $2,193,165, a decrease of $351,694, or 13.8%, as compared to $2,544,859 for the six months ended May 31, 2017. General and administrative expenses for the three months ended May 31, 2018 was $1,095,209, a decrease of $120,587, or 9.9%, as compared to $1,215,796 for the three months ended May 31, 2017. The decrease is due primarily to a decrease in legal fees incurred by the Company during the proxy contest and related settlement with certain shareholders of the Company and the completed tender offer in fiscal 2017. In the six months ended May 31, 2018, the Company incurred approximately $28,000 relating to the proxy contest. In the three months ended May 31, 2018 the Company did not incur costs related to the tender offer as compared to $88,621 incurred by the Company during the three months ended May 31 2017. In fiscal 2017, the Company incurred approximately $37,000 of expenses during the proxy contest and related settlement with certain shareholders of the Company and approximately $218,000 for the tender offer completed by the Company in March 2017 and other related expenses. The Company is in discussions with its insurance carrier regarding reimbursement for some of the costs the Company incurred in connection with the proxy contest and related settlement agreement. Offsetting increases are due to the hiring of additional employees as well as increases in utilities expenses, computer expenses and directors fees, and partially offset by decreases in temporary help expenses, officers compensation, stock promotion expenses as well as consulting expenses.

Depreciation expense for the six months ended May 31, 2018 was $24,486, an increase of $8,721, or 55.3%, as compared to $15,765 for the six months ended May 31, 2017. Depreciation expense for the three months ended May 31, 2018 was $12,532, an increase of $4,601 or 58%, as compared to $7,931 for the three months ended May 31, 2017. The increase is due to the Company purchasing or paying for new equipment during the six and three months ended May 31, 2018.

Investment income for the six months ended May 31, 2018 was $2, a decrease of $3,103 or 99.9% compared to $3,105 for the six months ended May 31, 2017. Investment income for the three months ended May 31, 2018 was $1, a decrease of $136 or 99.1% compared to $137 for the three months ended May 31, 2017. We attribute the decrease to a decrease in the Company's cash balance due to the purchase of our stock in the tender offer completed in March 2017.

Interest expense for the six months ended May 31, 2018 was $9,734, an increase of $2,919, or 42.8% compared to $6,815 for the six months ended May 31, 2017. Interest expense for the three months ended May 31, 2018 was $3,713, a decrease of $3,102, or 45.5% compared to $6,815 for the three months ended May 31, 2017. We attribute the increase to the utilization of a credit line during the six months ended May 31, 2018.We attribute the decrease in the three months ended May 31, 2018 to the Company paying down of its outstanding line of credit.

Tax expense for the six months ended May 31, 2018 was $46,673, an increase of $175,640, or 136.2% as compared to a tax benefit of $(128,967) for the six months ended May 31, 2017. Tax expense for the three months ended May 31, 2018 was $2,907, a decrease of $3,305, or 53.2% as compared to a tax expense of $6,212 for the three months ended May 31, 2017.The changes result from changes from the new U.S. tax law (primarily the effects of changes to the rates and alternative minimum tax rules starting in 2018), our net income (loss) for such periods and management's revised estimate of future taxable income and the related impact on the reported deferred tax. The change in the valuation allowance is based on management 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 income for the six months ended May 31, 2018 was $203,866, compared to a net loss of $453,507 for the six months ended May 31, 2017. Net income for the three months ended May 31, 2018 was $168,309, compared to a net loss of $103,334 for the three months ended May 31, 2017.

Liquidity and Capital Resources

As of May 31, 2018 we had cash of $1,307,144, and working capital of $3,856,614. 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, 2018, we had net cash flow provided by operating activities of $525,450, as compared to net cash flow used in operating activities of $(175,377), for the six months ended May 31, 2017. The increase in cash flow from operating activities resulted from increases in net income, depreciation expenses, accounts receivable and deferred income taxes as partially offset by decreases in cash provided by inventory, accrued expenses, accounts payable and prepaid expenses.

We had net cash flow used in investing activities of $(30,305) for the six months ended May 31, 2018, as compared to net cash flow used in investing activities of $(14,858) for the six months ended May 31, 2017. We attribute the change to the Company purchasing new equipment during the six months ended May 31, 2018.

We had net cash flow used in financing activities of $(275,000) during the six months ended May 31, 2018 as compared to $(6,350,000) used in financing activities for the six months ended May 31, 2017. The repayments of $275,000 of the line of credit reflect the change during the six months ended May 31, 2018. During the six months ended May 31, 2017, the Company utilized $7,150,000 to repurchase common stock in the tender offer as offset by $800,000 in net borrowing from the credit line.

As a result of the foregoing, the Company had a net increase in cash of $220,145 for the six months ended May 31, 2018, as compared to a net decrease in cash of $6,540,235 for the six months ended May 31, 2017.

In March 2017, the Company completed a tender offer whereby it purchased for cash 5,000,000 shares of its common stock, at a price of $1.43 per share, or $7,150,000. In February 2017, the Company obtained a line of credit of up to $3.0 million for working capital. In March 2017, the Company borrowed $1,000,000 under the line of credit for working capital purposes and to be repaid out of expected cash flows from operations. Since March 2017, the Company has repaid $775,000 under the line of credit and as of May 31, 2018 the balance on the line of credit was $225,000. As of May 31, 2018, the Company was in compliance with the covenant for the debt service coverage ratio for the line of credit.

The table below sets forth our contractual obligations, including long-term debt, operating leases and other long-term obligations, as of May 31, 2018:

		Payments due			
Contractual Obligations	Total	0 – 12 Months	13 – 36 Months	37 – 60 Months	More than 60 Months
Capital Lease Obligations	$35,280	$6,180	$15,461	$13,639	$ -
Operating leases	$428,371	$181,341	$247,030	$-	$ -
Total obligations	$463,651	$187,521	$262,491	$13,639	$ -

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, 2018 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, 2018 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.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

Exhibit Number	**Description**
31.1	Certification by principal executive officer and principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
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 16, 2018	By:	/s/ Ira Levy
	Name:	Ira Levy
	Title:	Chief Executive Officer (Principal Executive Officer, Principal Financial Officer and Principal Accounting Officer)