UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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 August 31, 2020

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

For the transition period from _______ to _______

Commission File No. 000-27688

SURGE COMPONENTS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**11-2602030**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
95 East Jefryn Boulevard Deer Park, New York	**11729**
(Address of principal executive offices)	(Zip Code)

(631) 595-1818
(Registrant's telephone number, including area code)

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 every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an 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	☒	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 ☒

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

The registrant's common stock outstanding as of October 9, 2020, was 5,437,526 shares of common stock. The registrant's common stock trades on the OTC Markets under the stock symbol "SPRS."

SURGE COMPONENTS, INC

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

	August 31, 2020 (unaudited)	November 30, 2019
ASSETS		
Current assets:		
Cash	$ 3,809,315	$ 2,739,305
Accounts receivable - net of allowance for doubtful accounts of $142,934 and $132,221	5,930,075	5,129,792
Inventory, net	3,726,531	3,593,231
Prepaid expenses and income taxes	474,694	486,940
Total current assets	13,940,615	11,949,268
Fixed assets – net of accumulated depreciation and amortization of $2,334,151 and $2,305,724	111,711	120,752
Operating Lease Right of Use Asset	1,702,391	-
Deferred income taxes	1,005,433	1,185,740
Other assets	22,607	22,607
Total assets	$ 16,782,757	$ 13,278,367

See notes to consolidated financial statements

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets
(Continued)

	August 31, 2020 (unaudited)	November 30, 2019
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,915,861	$ 3,344,182
Operating lease liabilities, current maturities	181,325	-
Financing lease payable, current maturities	8,345	7,782
Accrued expenses and taxes	557,014	581,201
Accrued salaries	535,812	506,663
Total current liabilities	5,198,357	4,439,828
Operating lease liabilities net of current maturities	1,535,292	-
Financing lease payable, net of current maturities	10,771	17,102
Note payable to bank	449,700	-
Deferred rent	-	12,998
Total liabilities	7,194,120	4,469,928
Commitments and contingencies		
Shareholders' equity:		
Preferred stock - $.001 par value, 5,000,000 shares authorized:		
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, 50,000,000 shares authorized, 5,437,526 and 5,320,026 shares issued and outstanding	5,437	5,319
Additional paid-in capital	16,948,532	16,666,465
Accumulated deficit	(7,365,342)	(7,863,355)
Total shareholders' equity	9,588,637	8,808,439
Total liabilities and shareholders' equity	$ 16,782,757	$ 13,278,367

See notes to consolidated financial statements.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Statements of Operations
(Unaudited)

	Nine Months Ended August 31,		Three Months Ended August 31,	
	2020	2019	2020	2019
Net sales	$ 22,103,444	$ 24,957,943	$ 8,667,255	$ 8,085,849
Cost of goods sold	15,913,093	17,749,039	6,405,274	5,670,293
Gross profit	6,190,351	7,208,904	2,261,981	2,415,556
Operating expenses:				
Selling and shipping expenses	1,814,955	2,011,634	583,984	717,399
General and administrative expenses	3,652,093	3,458,541	1,137,220	1,087,154
Depreciation and amortization	28,428	28,878	9,523	9,626
Total operating expenses	5,495,476	5,499,053	1,730,727	1,814,179
Income before other income (expense) and income taxes	694,875	1,709,851	531,254	601,377
Other income (expense):				
Other income	21,540	245	562	242
Interest expense	(1,566)	(2,079)	(477)	(652)
Other income (expense)	19,974	(1,834)	85	(410)
Income before income taxes	714,849	1,708,017	531,339	600,967
Income taxes (benefit)	211,836	(126,683)	(157,526)	(78,304)
Net income	503,013	1,834,700	688,865	679,271
Dividends on preferred stock	5,000	5,000	2,500	2,500
Net income available to common shareholders	$ 498,013	$ 1,829,700	$ 686,365	$ 676,771
Net income per share available to common shareholders:				
Basic	$ .09	$ .35	$ .13	$ .13
Diluted	$ .09	$ .33	$ .12	$ .12
Weighted Shares Outstanding:				
Basic	5,355,281	5,280,735	5,405,733	5,309,335
Diluted	5,512,948	5,463,928	5,563,400	5,492,527

See notes to consolidated financial statements

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders' Equity

Nine months ended August 31, 2020 and 2019

	Series C Preferred		Common		Additional Paid-In	Accumulated	
	Shares	Amount	Shares	Amount	Capital	Deficit	Total
Balance – December 1, 2018	10,000	$ 10	5,262,128	$ 5,262	$ 16,577,772	$ (9,893,210)	$ 6,689,834
Preferred stock dividends	-	-	-	-	-	(5,000)	(5,000)
Issuance of shares as compensation	-	-	47,207	46	88,704	-	88,750
Net Income	-	-	-	-	-	1,834,700	1,834,700
Balance – August 31, 2019	10,000	$ 10	5,309,335	$ 5,308	$ 16,666,465	$ (8,063,510)	$ 8,608,284

	Series C Preferred		Common		Additional Paid-In	Accumulated	
	Shares	Amount	Shares	Amount	Capital	Deficit	Total
Balance – December 1, 2019	10,000	$ 10	5,320,026	$ 5,319	$ 16,666,465	$ (7,863,355)	$ 8,808,439
Preferred stock dividends	-	-	-	-	-	(5,000)	(5,000)
Issuance of shares as compensation	-	-	42,500	43	216,892	-	216,935
Stock option exercise	-	-	75,000	75	65,175	-	65,250
Net Income	-	-	-	-	-	503,013	503,013
Balance – August 31, 2020	10,000	$ 10	5,437,526	$ 5,437	$ 16,948,532	$ (7,365,342)	$ 9,588,637

See notes to consolidated financial statements.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended	
	August 31, 2020	August 31, 2019
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$ 503,013	$ 1,834,700
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28,428	28,878
Deferred income taxes	180,307	(159,842)
Allowance for doubtful accounts	10,713	33,190
Stock Compensation	216,935	88,750
CHANGES IN OPERATING ASSETS AND LIABILITIES:		
Accounts receivable	(810,996)	415,358
Inventory	(133,300)	(374,137)
Prepaid expenses and income taxes	12,246	(292,140)
Other assets	1,228	(9,224)
Accounts payable	571,679	(826,209)
Deferred rent	-	(8,961)
Accrued expenses	(38)	(132,292)
NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	580,215	598,071
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of fixed assets	(19,387)	(7,221)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	$ (19,387)	$ (7,221)

See notes to consolidated financial statements.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows
(Continued)

	Nine Months Ended	
	August 31, 2020	August 31, 2019
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	$ 65,250	$ -
Proceeds from notes payable to bank	449,700	-
Repayment of financing lease obligations	(5,768)	(5,817)
NET CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES	509,182	(5,817)
NET CHANGE IN CASH	1,070,010	585,033
CASH AT BEGINNING OF PERIOD	2,739,305	1,761,863
CASH AT END OF PERIOD	$ 3,809,315	$ 2,346,896
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Income taxes paid	$ 125,478	$ 97,389
Interest paid	$ 1,566	$ 2,079
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Accrued dividends on preferred stock	$ 5,000	$ 5,000

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.

In February 2019, the Company converted into a Delaware corporation. The number of authorized shares of common stock was decreased to 50,000,000 shares.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) Principles of Consolidation and Basis of Presentation:

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 unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. ("U.S. GAAP") and the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Certain information and disclosures required by U.S. GAAP for complete consolidated financial statements have been condensed or omitted herein. The interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended November 30, 2019 filed with the SEC on February 28, 2020. The unaudited interim condensed consolidated financial information presented herein reflects all normal adjustments that are, in the opinion of management, necessary for a fair statement of the financial position, results of operations and cash flows for the periods presented. The Company is responsible for the unaudited interim consolidated financial statements included in this report. The results of operations of any interim period are not necessarily indicative of the results for the full year.

(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.

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.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(3) Revenue Recognition (continued):

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 our suppliers. The Company purchases the merchandise from the supplier and has the supplier directly ship to the customer through a freight forwarder. Title passes to customer upon the merchandise being received by a freight forwarder. Direct shipments were approximately $1,330,000 and $2,402,000 for the nine months ended August 31, 2020 and August 31, 2019 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 $280,274 and $462,111 for the nine months ended August 31, 2020 and August 31, 2019 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 $4,729,000 and $4,961,000 for the nine months ended August 31, 2020 and August 31, 2019 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 net realizable value. 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 August 31, 2020 was $540,853. The Company, at August 31, 2020 has a reserve against slow moving and obsolete inventory of $250,565. 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 cash and accounts receivable. The Company believes that concentration with regards to accounts receivable is limited due to its customer base. The Company maintains substantially all of its cash balances in a limited number of financial institutions. At August 31, 2020 and November 30, 2019, the Company's uninsured cash balances totaled $3,244,820 and $2,174,808, 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, accrued payroll 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 I.

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, 2016, and state tax examinations for years before fiscal years ending November 30, 2015. 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 tax 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 nine months ended August 31, 2020 and August 31, 2019.

(8) Cash Equivalents:

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

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(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 $2,654 and $4,573 for the nine months ended August 31, 2020 and August 31, 2019 respectively.

(13) Earnings Per Share

Basic earnings per share includes no dilution and is computed by dividing net (loss) income available to common stockholders by the weighted average number of common shares outstanding for the period. In the period with a profit, 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 August 31, 2020 and August 31, 2019 totaled 199,333 and 134,373, respectively.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(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.

(15) Leases

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases (Topic 842)* ("Topic 842"). Topic 842 requires the entity to recognize the assets and liabilities for the rights and obligations created by leased assets. Leases will be classified as either finance or operating, with classification affecting expense recognition in the income statement.

On December 1, 2019, the Company adopted Topic 842 applying the optional transition method, which allows an entity to apply the new standard at the adoption date with a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption. As a result of adopting Topic 842, the Company recognized assets and liabilities for the rights and obligations created by operating leases totaling approximately $290,000.

The Company determines if a contract contains a lease at inception based on whether it conveys the right to control the use of an identified asset. Substantially all of the Company's leases are classified as operating leases. The Company records operating lease right-of-use assets within "Other assets" and lease liabilities are recorded within "current and noncurrent liabilities" in the consolidated balance sheets. Lease expenses are recorded within "General and administrative expenses" in the consolidated statements of operations. Operating lease payments are presented within "Operating cash flows" in the consolidated statements of cash flows.

Operating lease right-of-use assets and lease liabilities are recognized based on the net present value of future minimum lease payments over the lease term starting on the commencement date. The Company generally is not able to determine the rate implicit in its leases and, as such, applies an incremental borrowing rate based on the Company's cost of borrowing for the relevant terms of each lease. Lease expense for minimum lease payments is recognized on a straight-line basis over the lease term. Lease terms may include an option to extend or terminate a lease if it is reasonably certain that the Company will exercise such options. The Company has elected the practical expedient to not separate lease components from non-lease components, and also has elected not to record a right-of-use asset or lease liability for leases which, at inception, have a term of twelve months or less. Variable lease payments are recognized in the period in which the obligation for those payments is incurred.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE C – FIXED ASSETS

Fixed assets consist of the following:

	August 31, 2020	November 30, 2019
Furniture and Fixtures	$ 327,971	$ 327,971
Leasehold Improvements	1,022,556	1,022,556
Computer Equipment	1,095,335	1,075,949
Less-Accumulated Depreciation	(2,334,151)	(2,305,724)
Net Fixed Assets	$ 111,711	$ 120,752

Depreciation and amortization expense for the nine months ended August 31, 2020 and August 31, 2019 was $28,428 and $28,878, respectively.

NOTE D – FINANCING LEASE OBLIGATIONS

The Company is obligated under financing leases for telephone equipment. The Company leases equipment under two capital lease arrangements with NEC Financial Services. 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%. The leases terminate in 2022.

Future minimum lease payments under these financing lease obligations as of August 31, 2020 are as follows:

2020	$ 9,779
2021	$ 9,779
2022	$ 1,786
Total	$ 21,344
Less: interest portion	2,228
Present value of net minimum lease payments	$ 19,116
Less: current portion	8,345
Non-current portion	$ 10,771

Financing lease obligations mature as follows:

Twelve Months Ended August 31:

2020	$ 8,345
2021	$ 9,158
2022	$ 1,613
Principal payments remaining	$ 19,116

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE E – LOANS PAYABLE

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). The Credit Line is collateralized by substantially all of the assets of the Company. As of August 31, 2020, the balance on the Credit Line was $0. As of August 31, 2020, the Company was in compliance with the debt covenants under the Credit Line.

The Company in May 2020 received loan proceeds in the amount of approximately $449,700 under the Paycheck Protection Program ("PPP"). The PPP, established as part of the Coronavirus Aid, Relief and Economic Security Act ("CARES Act"), provides for loans to qualifying businesses for amounts up to 2.5 times of the average monthly payroll expenses of the qualifying business. The loans and accrued interest are forgivable after twenty-four weeks as long as the borrower uses the loan proceeds for eligible purposes, including payroll, benefits, rent and utilities, and maintains its payroll levels. The amount of loan forgiveness will be reduced if the borrower terminates employees or reduces salaries during the period.

The unforgiven portion of the PPP loan is payable over two years at an interest rate of 1%, with a deferral of payments for the first six months. The Company intends to use the proceeds for purposes consistent with the PPP. While the Company currently believes that its use of the loan proceeds will meet the conditions for forgiveness of the loan, we cannot assure you that we will not take actions that could cause the Company to be ineligible for forgiveness of the loan, in whole or in part.

NOTE F – ACCRUED EXPENSES

Accrued expenses consist of the following:

	August 31, 2020	November 30, 2019
Commissions	$ 238,188	$ 233,784
Preferred stock dividends	151,569	146,569
Other accrued expenses	167,257	200,848
	$ 557,014	$ 581,201

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 $1,486,000 at November 30, 2019. Pension expense for the nine months ended August 31, 2020 and August 31, 2019 was $1,602 and $2,392, 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 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.

Between April 2001 and July 2015, 60,000 shares of the series C shares were repurchased or converted to common stock. Dividends aggregating $149,069 have not been paid for the semi-annual periods ended December 31, 2001 through the semi-annual payment due December 31, 2019. The Company has accrued these dividends. At August 31, 2020, 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 August 31, 2020.

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.

In March 2019, one employee director exercised options to acquire 25,000 shares of common stock at $0.87 per share.

[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 May 2019, a total of 47,207 shares were issued to the Company's officers as part of their 2018 bonus compensation under the 2015 Stock Plan.

In April 2020, the Company awarded one non-employee director 15,000 shares of its common stock under the 2015 Stock Plan. The Company recorded a cost of $21,150 related to the issuance of these shares.

In April 2020, a total of 27,500 shares were issued to one of the Company's officers as part of their 2019 bonus compensation under the 2015 Stock Plan. The Company recorded a cost of $41,250 relating to the issuance of these shares.

In April 2020, the Company granted stock options to (a) four non-employee directors to each purchase 15,000 shares of common stock, (b) one non-employee-director to purchase 25,000 shares of common stock, and (c) two Company officers to each purchase 50,000 shares of common stock at an exercise price of $1.41 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 $154,534 related to the granting of these options.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE H – SHAREHOLDERS' EQUITY (Continued)

Activity in the Company's stock plans for the period ended August 31, 2020 is summarized as follows:

	Shares	Weighted Average Exercise Price
Options outstanding December 1, 2019	147,000	$ 1.01
Options issued in the nine months ended August 31, 2020	185,000	$ 1.41
Options exercised in the nine months ended August 31, 2020	(75,000)	$ (0.87)
Options cancelled in the nine months ended August 31, 2020	-	$ -
Options outstanding at August 31, 2020	257,000	$ 1.34
Options exercisable at August 31, 2020	257,000	$ 1.34

The intrinsic value of the exercisable options at August 31, 2020 totaled $7,200. At August 31, 2020 the weighted average remaining life of the stock options is 3.48 years. At August 31, 2020 there was no unrecognized compensation cost related to the stock options granted under the plan.

[4] 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).

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE I – 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:

	August 31, 2020	November 30, 2019
Deferred Tax Assets		
Net operating loss	$ 1,287,289	$ 1,524,286
Allowance for bad debts	29,921	27,121
Inventory	60,746	60,746
Other	85,562	65,353
Depreciation	64,074	65,402
Total deferred tax assets	1,527,592	1,742,908
Valuation allowance	(522,159)	(557,168)
Deferred Tax Assets	$ 1,005,433	$ 1,185,740

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 $35,009 during the nine months ended August 31, 2020. 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 I – INCOME TAXES (Continued)

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

	Nine Months Ended	
	August 31, 2020	August 31, 2019
Current:		
Federal	$ -	$ (38,519)
States	31,529	71,678
	31,529	33,159
Deferred:		
Federal	142,442	(126,275)
States	37,865	(33,567)
	180,307	(159,842)
Provision for income taxes	$ 211,836	$ (126,683)

The Company files a consolidated income tax return with its wholly-owned subsidiaries and has net operating loss carryforwards of approximately $5,751,000 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:

	Nine Months ended	
	August 31, 2020	August 31, 2019
U.S Federal Income tax statutory rate	21%	21%
Valuation allowance	4%	(32)%
State income taxes	5%	4%
Other	-	-
Effective tax rate	30%	(7)%

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE J – OPERATING LEASE COMMITMENTS

The Company leases its office and warehouse space through 2030 from a corporation that is partially owned by officers/shareholders of the Company ("Related Company"). Annual minimum rental payments to the Related Company approximated $180,000 for the year ended November 30, 2019, and increase at the rate of two 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 2019, 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 $68,460.

In January 2019, the Company entered into a lease to rent warehouse space in Hong Kong for two years. Annual minimum rental payments for this space are approximately $36,840.

The Company's future minimum rental commitments at August 31, 2020 are as follows:

Twelve Months Ended August 31,

2021	$	258,528
2022		193,390
2023		197,258
2024		201,203
2025		205,227
2026 and after	$	1,108,281
	$	2,163,887

Net rental expense for the nine months ended August 31, 2020 and August 31, 2019 were $281,599 and $265,114 respectively, of which $200,156 and $197,418 respectively, was paid to the Related Company.

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE K – 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 L – MAJOR CUSTOMERS

The Company had two customers who accounted for 17% and 15% of net sales for the nine months ended August 31, 2020 and two customers who accounted for 13% and 12% of net sales for the nine months ended August 31, 2019. The Company had one customer who accounted for 16% of accounts receivable at August 31, 2020 and one customer who accounted for 11% of accounts receivable at August 31, 2019.

NOTE M – MAJOR SUPPLIERS

During the nine months ended August 31, 2020 and August 31, 2019 there was one foreign supplier accounting for 39% and 39% of total inventory purchased.

The Company purchases substantially all of its products overseas. For the nine months ended August 31, 2020, the Company purchased 45% of its products from Taiwan, 16% from Hong Kong, 25% 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 N – EXPORT SALES

The Company's export sales were as follows:

	Nine Months Ended	
	August 31, 2020	August 31, 2019
Canada	2,945,773	3,311,535
China	3,948,811	4,240,122
Other Asian Countries	1,099,040	1,811,454
South America	143,928	394,140
Europe	843,747	931,916

Revenues are attributed to countries based on location of customer.

NOTE O – SUBSEQUENT EVENTS

In early January 2020, an outbreak of a respiratory illness caused by the Coronavirus was identified in Wuhan, China. As part of its effort to combat the virus, the government of China has placed travel restrictions throughout parts of China. This has resulted in some of the Company's customers and suppliers being closed for an extended period or operating at significantly below their normal capacity and will also affect our suppliers that source some of their materials from China. Conditions in China have improved. Some customers and suppliers are back to full operation but others are taking longer. The duration and intensity of this global health emergency and related disruptions is uncertain, although there has been some improvement globally, including Asia, America and Europe. The duration of this crisis and its impact on both the Company's customers and supply chain is expected to have a material impact on the consolidated results of operations, cash flows and financial condition, but cannot be reasonably estimated at this time. As an update, the unprecedented virus has grown significantly especially in America and has significantly impacted the Company's customers. The Company has experienced order cancellations and order hold notices from customers and expects this to continue. Although the coronavirus situation is still very serious on a global basis, the Company's business has improved in the third quarter, with sales increasing and our customer's outlook for their business stronger at this time. This increase in business cannot be guaranteed to continue as it may be impacted by the coronavirus conditions, which change on an ongoing basis.

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. Furthermore, we cannot at this time assess the affect that the global outbreak of the novel Coronavirus may have on the Company.

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 most recent 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 $280,274 and $462,111 for the nine months ended August 31, 2020 and August 31, 2019 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 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 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 continue to centralize 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. Some of our customers have been involved in mergers and acquisitions, causing consolidation. This trend makes business more complicated and costly for the Company. The Company must have a presence in Asia and Europe to service and further develop the business. For these reasons, we established Surge Ltd., our Asia subsidiary, and hired a European salesman based in London. Currency fluctuations may 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 2020 to be a year of change and challenge, especially due to the coronavirus. 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. The global economic slowdown is impacted by the tariffs which may negatively impact the growth of our customers and many of the manufacturing companies in China. However, at this time some of the Company's products have become excluded from tariffs, so the Company has not yet experienced a material adverse effect from the tariffs.

The Coronavirus is impacting all of Asia, America and Europe and Surge Components seriously. Some of our customers and suppliers who had shut down or slowed operations are back to normal but others are taking longer. We are hopeful that things will return to normal as soon as possible. We are doing everything we can to keep customers production running and to keep things as smooth and stable as possible. We do expect that this could have a negative impact on our sales until production is fully running. Our customers in China and elsewhere have reduced their future purchases from us and will continue to reduce, if they are not able to complete the manufacturing of their products due to the shortage of components from other suppliers. The Company has also experienced order cancellations and order hold notices from customers and we expect this to continue. The duration of this crisis and its impact on both the Company's customers and supply chain had a negative impact on the nine month period ended August 31, 2020. The Company showed a decline in revenue of 11% for the nine months ended August 31, 2020. We expect the virus to continue to have a material impact on the Company's consolidated results for the balance of Fiscal 2020. Although the coronavirus situation is still serious globally, the Company's business has improved in the third quarter and our customers' outlook for their business is stronger than it was previously. We cannot guaranty that the increase in the third quarter will continue as the coronavirus conditions may change but management is very pleased with the third quarter results and cautiously optimistic about the remainder of Fiscal 2020.

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 net realizable value. Write-downs of inventories to net realizable 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 $38,000.

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 nine months ended August 31, 2020 decreased by $2,854,499 or 11.4%, to $22,103,444 as compared to net sales of $24,957,943 for the nine months ended August 31, 2019. Consolidated net sales for the three months ended August 31, 2020 increased by $581,406 or 7.2%, to $8,667,255 as compared to net sales of $8,085,849 for the three months ended August 31, 2019. We attribute the decrease in the nine months to a decrease in business with new customers as well as a decrease in additional business with existing customers. We attribute the increase in sales for the three months ended August 31, 2020 to an increase in business from existing customers partially due to their rebound from the Coronavirus as well as their business increasing. We can also attribute the decline in sales for the nine months ended August 31, 2020 to the impact of the virus in China, This has had an impact on the Company's sales in that we did not receive enough inventory from our suppliers to cover customer orders as well as the fact that our customers were not getting enough inventory from their other suppliers to complete their manufacturing and put some of our orders on hold. Net sales for the nine months ended August 31, 2020 and August 31, 2019 reflect $840,399 and $978,807, respectively of tariff costs that the Company was able to pass on to its customers.

Our gross profit for the nine months ended August 31, 2020 decreased by $1,018,553 to $6,190,351, or 14.1%, as compared to $7,208,904 for the nine months ended August 31, 2019. Gross margin as a percentage of net sales decreased slightly to 28% for the nine months ended August 31, 2020 compared to 28.9% for the nine months ended August 31, 2019. Gross profit for the three months ended August 31, 2020 decreased by $153,575 to $2,261,981, or 6.4%, as compared to $2,415,556 for the three months ended August 31, 2019. Gross margin as a percentage of net sales decreased to 26.1% for the three months ended August 31, 2020 compared to 29.9% for the three months ended August 31, 2019. The decrease in gross profit and profit margin can be attributed to the decrease in sales year to date due to the impact of the coronavirus as well as the mix of products that the Company sold at lower margins. 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. During the nine months ended August 31, 2020, the Company was impacted by tariff costs on certain products imported from China, which went into effect as of July 6, 2018. The Company has been able to pass along a portion of these costs to its customers. The Company is also moving some customer deliveries directly to Hong Kong in order to mitigate some of these costs.

Selling and shipping expenses for the nine months ended August 31, 2020 was $1,814,955, a decrease of $196,679, or 9.8% as compared to $2,011,634 for the nine months ended August 31, 2019. Selling and shipping expenses for the three months ended August 31, 2020 was $583,984, a decrease of $133,415, or 18.6%, as compared to $717,399 for the three months ended August 31, 2019. We attribute the decrease to decreases in selling expenses such as commission expense, travel expenses and entertainment expenses, and auto expenses offset by increases in salesman payroll, due to the hiring of a new salesperson and freight out expenses.

General and administrative expenses for the nine months ended August 31, 2020 was $3,652,093, an increase of $193,552, or 5.6%, as compared to $3,458,541 for the nine months ended August 31, 2019. General and administrative expenses for the three months ended August 31, 2020 was $1,137,220, an increase of $50,066, or 4.6%, as compared to $1,087,154 for the three months ended August 31, 2019.The increase is due primarily to increases in salaries and related payroll tax expenses, rent expenses, general insurance, and bank charges as well as directors fees and office expense and professional fees, as partially offset by decreases in utilities, telephone expenses, as well as maintenance expenses, temporary help expenses, bad debt and computer expenses.

Depreciation expense for the nine months ended August 31, 2020 was $28,428, a decrease of $450, or 1.6%, as compared to $28,878 for the nine months ended August 31, 2019. Depreciation expense for the three months ended August 31, 2020 was $9,522, a decrease of $103, or 1.1%, as compared to $9,626 for the three months ended August 31, 2019. The decrease is due the company purchasing less equipment during the nine months ended August 31, 2020.

Other income for the nine months ended August 31, 2020 was $21,540, an increase of $21,295 compared to $245 for the nine months ended August 31, 2019. Other income for the three months ended August 31, 2020 was $562, an increase of $320 compared to $242 for the [three] months ended August 31, 2019. We attribute the increase to Company receiving $20,000 for Covid-19 relief from the SBA as well as an increase in the cash balances for the nine months ended August 31, 2020.

Interest expense for the nine months ended August 31, 2020 was $1,566, a decrease of $513, or 24.7% compared to $2,079 for the nine months ended August 31, 2019. Interest expense for the three months ended August 31, 2020 was $477, a decrease of $175 or 26.8% compared to $652 for the three months ended August 31, 2019. We attribute the decrease to the Company not utilizing the line of credit during the nine months ended August 31, 2020.

Tax expense for the nine months ended August 31, 2020 was $211,836 an increase $338,519 as compared to a tax benefit of $126,683 for the nine months ended August 31, 2019. Tax benefit for the three months ended August 31, 2020 was $157,526 an increase of $79,222 as compared to a tax benefit of $78,304 for the three months ended August 31, 2019. The changes result from our net income 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 nine months ended August 31, 2020 was $503,013, compared to a net income of $1,834,700 for the nine months ended August 31, 2019. As a result of the foregoing, net income for the three months ended August 31, 2020 was $688,865, compared to a net income of $679,271 for the three months ended August 31, 2019.

Liquidity and Capital Resources

As of August 31, 2020 we had cash of $3,809,315, and working capital of $8,742,258. We believe that our working capital levels are adequate to meet our operating requirements during at least the next twelve months. The Company is exploring and evaluating opportunities for growth and expansion using the Company's cash resources.

During the nine months ended August 31, 2020, we had net cash flow provided by operating activities of $580,215, as compared to net cash flow provided by operating activities of $598,071 for the nine months ended August 31, 2019. The decrease in cash flow from operating activities resulted from cash flows provided by net income, accounts payable, deferred income taxes and prepaid expenses as partially offset by cash flows used in accounts receivable, inventory and accrued expenses.

We had net cash flow used in investing activities of $(19,387) for the nine months ended August 31, 2020, as compared to net cash flow used in investing activities of $(7,221) for the nine months ended August 31, 2019. We attribute the change to the Company purchasing more equipment during the nine months ended August 31, 2020.

We had net cash flow provided by financing activities of $509,182 during the nine months ended August 31, 2020 as compared to $(5,817) used in financing activities for the nine months ended August 31, 2019. We attribute the increase to proceeds from the exercising of stock options and the funding received from the bank related to the Paycheck Protection Program during the nine months ended August 31, 2020.

As a result of the foregoing, the Company had a net increase in cash of $1,070,010 for the nine months ended August 31, 2020, as compared to a net increase in cash of $585,033 for the nine months ended August 31, 2019.

The table below sets forth our contractual obligations, including long-term debt, operating leases and other long-term obligations, as of August 31, 2020:

		Payments due			
Contractual Obligations	Total	0 – 12 Months	13 – 36 Months	37 – 60 Months	More than 60 Months
Financing Lease Obligations	$ 19,116	$ 8,345	$ 10,771	$ -	$ -
Operating Right of Use Leases	$ 2,161,887	258,528	390,648	406,430	1,106,281
Total obligations	$ 2,181,003	$ 266,873	$ 401,419	$ 406,430	$ 1,106,281

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 August 31, 2020 and has concluded that, as of such date, our disclosure controls and procedures were effective.

Changes in Internal Controls

During the three months ended August 31, 2020 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
4.1	Rights Agreement dated as of October 7, 2016 between Surge Components, Inc., as the Company, and Continental Stock Transfer & Trust Company, as Rights Agent, incorporated by reference to Exhibit 4.1 of the Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on October 7, 2016.
4.2	Amendment to the Rights Agreement dated as of October 6, 2019 between Surge Components, Inc., as the Company, and Continental Stock Transfer & Trust Company, as Rights Agent filed with Form 10-Q on October 15, 2019.
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
10.1	Rental Agreement between Great American Realty and Surge Components dated July 28, 2020
10.2	Rental Agreement between Great American Realty and Challenge Electronics dated July 28, 2020
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: October 15, 2020

By: /s/ Ira Levy
Name: Ira Levy
Title: Chief Executive Officer
(Principal Executive Officer,
Principal Financial Officer and
Principal Accounting Officer)

Exhibit 10.1

Mailed 1/26/15

PLEASE SIGN AND RETURN BOTH COPIES

Landlord Great American Realty
2131 Newbridge Road
Bellmore NY 11710

EXTENSION OF LEASE

Date January 15, 2015

Tenant(s): Surge Components, Inc.	Re: LEASE Ten Year
Premises: 95 Jefryn Boulevard	Dated October 1, 2020
Deer Park, New York 11729	Expires on September 30, 2030
	Apt. — office — etc.:

Dear Tenant(s): Surge Components, Inc.

The LEASE referred to above expires shortly. If you wish to extend your LEASE the annual rent for the premises commencing on October 1, 2020 will be $ payable $ monthly in advance, for an extended term of ten year

Please note your rent is due and payable by the first day of each month.

A late charge of 5% will be assessed after the 5th day of the month.

Tenant agrees to supply a valid Certificate of Insurance showing tenants contents and liability coverage.

PLEASE SEE ATTACHED

In connection with the foregoing, additional security will be required in the amount of $ making the total security of $

If prior to the commencement of the extended term you default in any of the terms, covenants and conditions of the LEASE this agreement shall, at the option of the Landlord, be null and void.

All other terms, covenants and conditions of the LEASE shall remain in full force and effect for the duration of the extended term.

If you wish to extend the term of the LEASE please sign this agreement where indicated (X) and return two copies to the Landlord together with a check in the amount of the additional security within 15 days of the above date.

If you intend to vacate the premises please sign your name under the words "Tenant(s) will vacate the premises at the end of the present term" and return two copies to the Landlord.

SIGN HERE TO EXTEND LEASE

Tenant(s): X [signature]
(each Tenant on original Lease must sign) X

Tenant(s) will vacate the premises at the end of the term

This EXTENSION AGREEMENT does not become binding until the return to you of a copy signed by the Landlord.

Landlord
By: [signature]
Great American Realty of Jefryn Boulevard, LLC

T 195—Extension of Lease

During the Term, Tenant shall pay Owner annual fixed rent ("Fixed Rent"), as follows:

1. From October 1st, 2020 through and including September 30th, 2021, Fixed Rent shall be Ninety-Four Thousand Nine Hundred Fifty-Four Dollars and Eight Cents ($94,954.08); payable in equal monthly installments of Seven Thousand Nine Hundred Twelve Dollars and Eighty-Four Cents ($7,912.84); and

2. From October 1st, 2021 through and including September 30th, 2022, Fixed Rent shall be Ninety-Six Thousand Eight Hundred Fifty-Three Dollars and Twenty Cents ($96,853.20), payable in equal monthly installments of Eight Thousand Seventy-One Dollars and Ten Cents ($8,071.10); and

3. From October 1st, 2022 through and including September 30th, 2023, Fixed Rent shall be Ninety-Eight Thousand Seven Hundred Ninety Dollars and Twenty-Four Cents ($98,790.24), payable in equal monthly installments of Eight Thousand Two Hundred Thirty-Two Dollars and Fifty-Two Cents ($8,232.52); and

4. From October 1st, 2023 through and including September 30th, 2024, Fixed Rent shall be One Hundred Thousand Seven Hundred Sixty-Six Dollars and Four Cents ($100,766.04), payable in equal monthly installments of Eight Thousand Three Hundred Ninety-Seven Dollars Seventeen Cents ($8,397.17); and

5. From October 1st, 2024 through and including September 30th, 2025, Fixed Rent shall be One Hundred Two Thousand Seven Hundred Eighty-One Dollars and Thirty-Two Cents ($102,781.32), payable in equal monthly installments of Eight Thousand Five Hundred Sixty-Five Dollars and Eleven Cents ($8,565.11); and

6. From October 1st, 2025 through and including September 30th, 2026, Fixed Rent shall be One Hundred Four Thousand Eight Hundred Thirty-Six Dollars and Ninety-Two Cents ($104,836.92); payable in equal monthly installments of Eight Thousand Seven Hundred Thirty-Six Dollars and Forty-One Cents ($8,736.41); and

7. From October 1st, 2026 through and including September 30th, 2027, Fixed Rent shall be One Hundred Six Thousand Nine Hundred Thirty-Three Dollars and Sixty-Eight Cents ($106,933.68), payable in equal monthly installments of Eight Thousand Nine Hundred Eleven Dollars and Fourteen Cents ($8,911.14); and

8. From October 1st, 2027 through and including September 30th, 2028, Fixed Rent shall be One Hundred Nine Thousand Seventy-two Dollars and Thirty-Two Cents ($109,072.32), payable in equal monthly installments of Nine Thousand Eighty-Nine Dollars and Thirty-Six Cents ($9,089.36); and

9. From October 1st, 2028 through and including September 30th, 2029, Fixed Rent shall be One Hundred Eleven Thousand Two Hundred Fifty-Three Dollars and Eighty Cents ($111,253.80), payable in equal monthly installments of Nine Thousand Two Hundred Seventy-One Dollars and Fifteen Cents ($9,271.15); and

10. From October 1st, 2029 through and including September 30th, 2030, Fixed Rent shall be One Hundred Thirteen Thousand Four Hundred Seventy-Eight Dollars and Eighty-Four Cents ($113,478.84), payable in equal monthly installments of Nine Thousand Four Hundred Fifty-Six Dollars and Fifty-Seven Cents ($9,456.57).

Exhibit 10.2

mailed 1/26/15

PLEASE SIGN AND RETURN BOTH COPIES

Great American Realty
Landlord 2131 Newbridge Road
Bellmore NY 11710

EXTENSION OF LEASE

Date January 15, 2015

Tenant(s): Challenge Electronics, Inc.
Premises: 95 Jefryn Boulevard
Deer Park, New York 11729

Re: LEASE Ten Year
Dated October 1, 2020
Expires on September 30, 2030
Apt. — office — etc.:

Dear Tenant(s): Challenge Electronics, Inc.

The LEASE referred to above expires shortly. If you wish to extend your LEASE the annual rent for the premises commencing on October 1, 2020 will be $ payable $ monthly in advance, for an extended term of ten year

Please note your rent is due and payable by the first day of each month.

A late charge of 5% will be assessed after the 5th day of the month.

Tenant agrees to supply a valid Certificate of Insurance showing tenants contents and liability coverage.

PLEASE SEE ATTACHED

In connection with the foregoing, additional security will be required in the amount of $ making the total security of $

If prior to the commencement of the extended term you default in any of the terms, covenants and conditions of the LEASE this agreement shall, at the option of the Landlord, be null and void.

All other terms, covenants and conditions of the LEASE shall remain in full force and effect for the duration of the extended term.

If you wish to extend the term of the LEASE please sign this agreement where indicated (X) and return two copies to the Landlord together with a check in the amount of the additional security within 15 days of the above date.

If you intend to vacate the premises please sign your name under the words "Tenant(s) will vacate the premises at the end of the present term" and return two copies to the Landlord.

SIGN HERE TO EXTEND LEASE

Tenant(s): X ______________
each Tenant on original Lease must sign X ______________

This EXTENSION AGREEMENT does not become binding until the return to you of a copy signed by the Landlord.

Tenant(s) will vacate the premises at the end of the term
____
____

Landlord
By ______________
Great American Realty of Jefryn Boulevard, LLC

T 195—Extension of Lease

During the Term, Tenant shall pay Owner annual fixed rent ("Fixed Rent"), as follows:

1. From October 1st, 2020 through and including September 30th, 2021, Fixed Rent shall be Ninety-Four Thousand Nine Hundred Fifty-Four Dollars and Eight Cents ($94,954.08); payable in equal monthly installments of Seven Thousand Nine Hundred Twelve Dollars and Eighty-Four Cents ($7,912.84); and

2. From October 1st, 2021 through and including September 30th, 2022, Fixed Rent shall be Ninety-Six Thousand Eight Hundred Fifty-Three Dollars and Twenty Cents ($96,853.20), payable in equal monthly installments of Eight Thousand Seventy-One Dollars and Ten Cents ($8,071.10); and

3. From October 1st, 2022 through and including September 30th, 2023, Fixed Rent shall be Ninety-Eight Thousand Seven Hundred Ninety Dollars and Twenty-Four Cents ($98,790.24), payable in equal monthly installments of Eight Thousand Two Hundred Thirty-Two Dollars and Fifty-Two Cents ($8,232.52); and

4. From October 1st, 2023 through and including September 30th, 2024, Fixed Rent shall be One Hundred Thousand Seven Hundred Sixty-Six Dollars and Four Cents ($100,766.04), payable in equal monthly installments of Eight Thousand Three Hundred Ninety-Seven Dollars Seventeen Cents ($8,397.17); and

5. From October 1st, 2024 through and including September 30th, 2025, Fixed Rent shall be One Hundred Two Thousand Seven Hundred Eighty-One Dollars and Thirty-Two Cents ($102,781.32), payable in equal monthly installments of Eight Thousand Five Hundred Sixty-Five Dollars and Eleven Cents ($8,565.11); and

6. From October 1st, 2025 through and including September 30th, 2026, Fixed Rent shall be One Hundred Four Thousand Eight Hundred Thirty-Six Dollars and Ninety-Two Cents ($104,836.92); payable in equal monthly installments of Eight Thousand Seven Hundred Thirty-Six Dollars and Forty-One Cents ($8,736.41); and

7. From October 1st, 2026 through and including September 30th, 2027, Fixed Rent shall be One Hundred Six Thousand Nine Hundred Thirty-Three Dollars and Sixty-Eight Cents ($106,933.68), payable in equal monthly installments of Eight Thousand Nine Hundred Eleven Dollars and Fourteen Cents ($8,911.14); and

8. From October 1st, 2027 through and including September 30th, 2028, Fixed Rent shall be One Hundred Nine Thousand Seventy-two Dollars and Thirty-Two Cents ($109,072.32), payable in equal monthly installments of Nine Thousand Eighty-Nine Dollars and Thirty-Six Cents ($9,089.36); and

9. From October 1st, 2028 through and including September 30th, 2029, Fixed Rent shall be One Hundred Eleven Thousand Two Hundred Fifty-Three Dollars and Eighty Cents ($111,253.80), payable in equal monthly installments of Nine Thousand Two Hundred Seventy-One Dollars and Fifteen Cents ($9,271.15); and

10. From October 1st, 2029 through and including September 30th, 2030, Fixed Rent shall be One Hundred Thirteen Thousand Four Hundred Seventy-Eight Dollars and Eighty-Four Cents ($113,478.84), payable in equal monthly installments of Nine Thousand Four Hundred Fifty-Six Dollars and Fifty-Seven Cents ($9,456.57).

Exhibit 31.1

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
AND PRINCIPAL FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Ira Levy, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Surge Components, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 15, 2020

By: /s/ Ira Levy
Ira Levy
Chief Executive Officer
(Principal Executive Officer and
Principal Financial Officer)

Exhibit 32.1

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

In connection with the Quarterly Report of Surge Components, Inc. (the "Company") on Form 10-Q for the period ended August 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ira Levy, Chief Executive Officer (principal executive officer and principal financial officer) of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 15, 2020

By: /s/ Ira Levy
Ira Levy
Chief Executive Officer
(Principal Executive Officer and
Principal Financial Officer)