

**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 February 29, 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 | <input type="checkbox"/>            | Accelerated Filer         | <input type="checkbox"/>            |
| Non-accelerated Filer   | <input checked="" type="checkbox"/> | Smaller reporting company | <input checked="" type="checkbox"/> |
|                         |                                     | Emerging growth company   | <input type="checkbox"/>            |

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

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

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

The registrant's common stock outstanding as of April 13, 2020, was 5,320,026 shares of common stock. The registrant's common stock trades on the OTC Markets under the stock symbol "SPRS."

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**PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS.****SURGE COMPONENTS, INC. AND SUBSIDIARIES**

## Consolidated Balance Sheets

|  | February 29,<br>2020<br>(unaudited) | November 30,<br>2019 |
|--|-------------------------------------|----------------------|
| <b>ASSETS</b>  |                                     |                      |
| Current assets:  |                                     |                      |
| Cash   | \$ 3,331,796                        | \$ 2,739,305         |
| Accounts receivable - net of allowance for doubtful accounts of \$132,221 and \$132,221        | 4,577,518                           | 5,129,792            |
| Inventory, net   | 3,139,255                           | 3,593,231            |
| Prepaid expenses and income taxes  | 342,546                             | 486,940              |
| Total current assets   | 11,391,115                          | 11,949,268           |
| Fixed assets – net of accumulated depreciation and amortization of \$2,315,088 and \$2,305,724 | 126,731                             | 120,752              |
| Operating Lease Right of Use Asset   | 214,857                             | -                    |
| Deferred income taxes  | 944,164                             | 1,185,740            |
| Other assets   | 22,607                              | 22,607               |
| Total assets   | <u>\$ 12,699,474</u>                | <u>\$ 13,278,367</u> |

See notes to consolidated financial statements

**SURGE COMPONENTS, INC. AND SUBSIDIARIES**Consolidated Balance Sheets  
(Continued)

|   | February 29,<br>2020<br>(unaudited) | November 30,<br>2019 |
|---|-------------------------------------|----------------------|
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                                     |                      |
| Current liabilities:  |                                     |                      |
| Accounts payable  | \$ 2,991,008                        | \$ 3,344,182         |
| Operating Lease Liabilities   | 225,275                             | -                    |
| Financing lease payable, current maturities   | 7,965                               | 7,782                |
| Accrued expenses and taxes  | 522,632                             | 581,201              |
| Accrued salaries  | 395,416                             | 506,663              |
| <b>Total current liabilities</b>  | <b>4,142,296</b>                    | <b>4,439,828</b>     |
| Financing lease payable, net of current maturities  | 15,041                              | 17,102               |
| Deferred rent   | -                                   | 12,998               |
| <b>Total liabilities</b>  | <b>4,157,337</b>                    | <b>4,469,928</b>     |
| 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, 5,320,026 and 5,320,026 shares issued and outstanding  | 5,319                               | 5,319                |
| Additional paid-in capital  | 16,666,465                          | 16,666,465           |
| Accumulated deficit   | (8,129,657)                         | (7,863,355)          |
| <b>Total shareholders' equity</b>   | <b>8,542,137</b>                    | <b>8,808,439</b>     |
| <b>Total liabilities and shareholders' equity</b>   | <b>\$ 12,699,474</b>                | <b>\$ 13,278,367</b> |

See notes to consolidated financial statements.

**SURGE COMPONENTS, INC. AND SUBSIDIARIES**

Consolidated Statements of Operations  
(Unaudited)

|   | Three Months Ended   |                      |
|---|----------------------|----------------------|
|   | February 29,<br>2020 | February 28,<br>2019 |
| Net sales   | \$ 6,789,138         | \$ 8,407,342         |
| Cost of goods sold  | <u>4,903,362</u>     | <u>6,083,782</u>     |
| Gross profit  | <u>1,885,776</u>     | <u>2,323,560</u>     |
| Operating expenses:   |                      |                      |
| Selling and shipping expenses                                 | 656,838              | 642,896              |
| General and administrative expenses                           | 1,189,240            | 1,087,037            |
| Depreciation and amortization                                 | <u>9,364</u>         | <u>9,578</u>         |
| Total operating expenses                                      | <u>1,855,442</u>     | <u>1,739,511</u>     |
| Income before other income and income taxes                   | <u>30,334</u>        | <u>584,049</u>       |
| Other (expense) income:                                       |                      |                      |
| Interest expense  | (567)                | (733)                |
| Other income  | <u>518</u>           | <u>1</u>             |
| Other income (expense):                                       | <u>(49)</u>          | <u>(732)</u>         |
| Income before income taxes                                    | 30,285               | 583,317              |
| Income taxes (benefit)  | <u>294,087</u>       | <u>(110,480)</u>     |
| Net (Loss) income   | \$ (263,802)         | \$ 693,797           |
| Dividends on preferred stock                                  | <u>2,500</u>         | <u>2,500</u>         |
| Net (Loss) income available to common shareholders            | <u>\$ (266,302)</u>  | <u>\$ 691,297</u>    |
| Net (Loss) income per share available to common shareholders: |                      |                      |
| Basic   | <u>\$ (.05)</u>      | <u>\$ .13</u>        |
| Diluted   | <u>\$ (.05)</u>      | <u>\$ .13</u>        |
| Weighted Shares Outstanding:                                  |                      |                      |
| Basic   | <u>5,320,026</u>     | <u>5,262,128</u>     |
| Diluted   | <u>5,320,026</u>     | <u>5,362,128</u>     |

See notes to consolidated financial statements.

**SURGE COMPONENTS, INC. AND SUBSIDIARIES**Consolidated Statements of Cash Flows  
(Unaudited)

|  | Three Months Ended   |                      |
|--|----------------------|----------------------|
|  | February 29,<br>2020 | February 28,<br>2019 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                      |                      |
| Net (Loss) Income  | \$ (263,802)         | \$ 693,797           |
| Adjustments to reconcile net (Loss) income to net cash provided by operating activities: |                      |                      |
| Depreciation and amortization  | 9,364                | 9,578                |
| Deferred income taxes  | 241,576              | (115,861)            |
| Allowance for doubtful accounts  | -                    | (1,797)              |
| <b>CHANGES IN OPERATING ASSETS AND LIABILITIES:</b>                                      |                      |                      |
| Accounts receivable  | 552,274              | 394,982              |
| Inventory  | 453,976              | 38,696               |
| Prepaid expenses and income taxes  | 144,394              | (17,247)             |
| Other assets   | (2,580)              | (9,223)              |
| Accounts payable   | (353,174)            | (788,049)            |
| Deferred rent  | -                    | (2,987)              |
| Accrued expenses   | (172,316)            | (138,340)            |
| <b>NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES</b>                                   | <b>609,712</b>       | <b>63,549</b>        |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                      |                      |
| Acquisition of fixed assets  | (15,343)             | (5,580)              |
| <b>NET CASH FLOWS USED IN INVESTING ACTIVITIES</b>                                       | <b>\$ (15,343)</b>   | <b>\$ (5,580)</b>    |

**SURGE COMPONENTS, INC. AND SUBSIDIARIES**Consolidated Statements of Cash Flows  
(Continued)

|  | Three Months Ended   |                      |
|--|----------------------|----------------------|
|  | February 29,<br>2020 | February 28,<br>2019 |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>             |                      |                      |
| Repayment of Financing Lease Obligations                 | \$ (1,878)           | \$ (3,311)           |
| <b>NET CASH FLOWS USED IN FINANCING ACTIVITIES</b>       | <u>(1,878)</u>       | <u>(3,311)</u>       |
| <b>NET CHANGE IN CASH</b>                                | 592,491              | 54,658               |
| <b>CASH AT BEGINNING OF PERIOD</b>                       | <u>2,739,305</u>     | <u>1,761,863</u>     |
| <b>CASH AT END OF PERIOD</b>                             | <u>\$ 3,331,796</u>  | <u>\$ 1,816,521</u>  |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b> |                      |                      |
| Income taxes paid  | \$ 47,355            | \$ 3,739             |
| Interest paid  | \$ 567               | \$ 733               |
| <b>NONCASH INVESTING AND FINANCING ACTIVITIES:</b>       |                      |                      |
| 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.

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:

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 three months ended February 29, 2020 and February 28, 2019 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.

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 \$274,000 and \$702,000 for the three months ended February 29, 2020 and February 28, 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 \$76,675 and \$22,029 for the three months ended February 29, 2020 and February 28, 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 \$1,357,000 and \$1,519,000 for the three months ended February 29, 2020 and February 28, 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 February 29, 2020 was \$449,222. The Company, at February 29, 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 accounts receivable. The Company maintains substantially all of its cash balances in a limited number of financial institutions. At February 29, 2020 and November 30, 2019, the Company's uninsured cash balances totaled \$2,767,300 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 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.

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, 2015, and state tax examinations for years before fiscal years ending November 30, 2014. 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 three months ended February 29, 2020 and February 28, 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 \$1,342 and \$1,220 for the three months ended February 29, 2020 and February 28, 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 February 29, 2020 and February 28, 2019 totaled 164,370 and 172,000, 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:

|                               | February 29,<br>2020 | November 30,<br>2019 |
|-------------------------------|----------------------|----------------------|
| Furniture and Fixtures        | \$ 327,971           | \$ 327,971           |
| Leasehold Improvements        | 1,022,556            | 1,022,556            |
| Computer Equipment            | 1,091,292            | 1,075,949            |
| Less-Accumulated Depreciation | (2,315,088)          | (2,305,724)          |
| Net Fixed Assets              | <u>\$ 126,731</u>    | <u>\$ 120,752</u>    |

Depreciation and amortization expense for the three months ended February 29, 2020 and February 28, 2019 was \$9,364 and \$9,578, 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 February 29, 2020 are as follows:

|   |                  |
|---|------------------|
| 2020  | \$ 9,779         |
| 2021  | \$ 9,779         |
| 2022  | <u>\$ 6,706</u>  |
| Total                                       | \$ 26,264        |
| Less: interest portion                      | 3,258            |
| Present value of net minimum lease payments | \$ 23,006        |
| Less: current portion                       | 7,965            |
| Non-current portion                         | <u>\$ 15,041</u> |

Financing lease obligations mature as follows:

Twelve Months Ended February 28:

|                              |                  |
|------------------------------|------------------|
| 2020                         | \$ 7,965         |
| 2021                         | \$ 8,742         |
| 2022                         | <u>\$ 6,299</u>  |
| Principal payments remaining | <u>\$ 23,006</u> |

**SURGE COMPONENTS, INC. AND SUBSIDIARIES**

## Notes to Consolidated Financial Statements

NOTE E – LOAN 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 February 29, 2020, the balance on the Credit Line was \$0. As of February 29, 2020, the Company was in compliance with the debt covenants under the Credit Line.

NOTE F – ACCRUED EXPENSES

Accrued expenses consist of the following:

|                           | February 29,<br>2020 | November 30,<br>2019 |
|---------------------------|----------------------|----------------------|
| Commissions               | \$ 219,439           | \$ 233,784           |
| Preferred stock dividends | 149,069              | 146,569              |
| Other accrued expenses    | 154,124              | 200,848              |
|                           | <u>\$ 522,632</u>    | <u>\$ 581,201</u>    |

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 three months ended February 29, 2020 and February 28, 2019 was \$387 and \$1,100, 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 February 29, 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 February 29, 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.

Activity in the 2010 Stock Plan for the year ended February 29, 2020 is summarized as follows:

|   | Shares         | Weighted<br>Average<br>Exercise<br>Price |
|---|----------------|--|
| Options outstanding December 1, 2019                          | 147,000        | \$ 1.01                                  |
| Options issued in the three months ended February 29, 2020    | -              | \$ -                                     |
| Options exercised in the three months ended February 29, 2020 | -              | \$ -                                     |
| Options cancelled in the three months ended February 29, 2020 | -              | \$ -                                     |
| Options or of electronic outstanding at February 29, 2020     | <u>147,000</u> | <u>\$ 1.01</u>                           |
| Options exercisable at February 29, 2020                      | <u>147,000</u> | <u>\$ 1.01</u>                           |

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.

The intrinsic value of the exercisable options at February 29, 2020 totaled \$87,150. At February 29, 2020 the weighted average remaining life of the stock options is 0.67 years. At February 29, 2020 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] 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 December 22, 2016, the Company entered into a settlement agreement (the “Settlement Agreement”) with Michael D. Tofias and Bradley P. Rexroad (collectively, the “Stockholders”). The Settlement Agreement generally provided that:

- 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 annual meeting;
- 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, and
- the Company will commence an issuer tender offer to all of its stockholders to repurchase at least 5.0 million shares of its common stock at a price of \$1.43 per share (the “Tender Offer”), which the Company completed in March 2017 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.
- 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; and
- 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.
- 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.

**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;
- 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.

On April 6, 2017, the Board of Directors elected Peter Levy as a Class C Director. He is an independent director.

On October 4, 2018, the Company held its annual meeting of shareholders, at which shareholders approved (i) the change in the Company's state of incorporation from Nevada to Delaware and (ii) the declassification of the Company's board of directors on a rolling basis. No shareholders exercised their dissenters' rights in connection with the annual meeting.

The Settlement Agreement terminated on February 5, 2019, the date on which the Company completed its reincorporation from Nevada into Delaware.

**SURGE COMPONENTS, INC. AND SUBSIDIARIES**

## Notes to Consolidated Financial Statements

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:

|                           | February 29,<br>2020 | November 30,<br>2019 |
|---------------------------|----------------------|----------------------|
| Deferred Tax Assets       |                      |                      |
| Net operating loss        | \$ 1,517,469         | \$ 1,524,286         |
| Allowance for bad debts   | 27,121               | 27,121               |
| Inventory                 | 60,746               | 60,746               |
| Other                     | 80,130               | 65,353               |
| Depreciation              | 65,110               | 65,402               |
| Total deferred tax assets | 1,750,576            | 1,742,908            |
| Valuation allowance       | (806,412)            | (557,168)            |
|                           | <u>\$ 944,164</u>    | <u>\$ 1,185,740</u>  |

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 increased by approximately \$249,244 during the three months ended February 29, 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 J – INCOME TAXES (Continued)

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

|                            | <u>Three Months Ended</u>    |                              |
|----------------------------|------------------------------|------------------------------|
|                            | <u>February 29,<br/>2020</u> | <u>February 28,<br/>2019</u> |
| Current:                   |                              |                              |
| Federal                    | \$ -                         | \$ -                         |
| States                     | 52,511                       | 5,381                        |
|                            | <u>52,511</u>                | <u>5,381</u>                 |
| Deferred:                  |                              |                              |
| Federal                    | 190,845                      | (91,530)                     |
| States                     | 50,731                       | (24,331)                     |
|                            | <u>241,576</u>               | <u>(115,861)</u>             |
| Provision for income taxes | <u>\$ 294,087</u>            | <u>\$ (110,480)</u>          |

The Company files a consolidated income tax return with its wholly-owned subsidiaries and has net operating loss carryforwards of approximately \$5,830,000 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:

|                                       | <u>Three Months ended</u>    |                              |
|---------------------------------------|------------------------------|------------------------------|
|                                       | <u>February 29,<br/>2020</u> | <u>February 28,<br/>2019</u> |
| U.S Federal Income tax statutory rate | 21%                          | 21%                          |
| Valuation allowance                   | 945%                         | (47)%                        |
| State income taxes                    | 5%                           | 7%                           |
| Other                                 | -                            | -                            |
| Effective tax rate                    | <u>971%</u>                  | <u>(19)%</u>                 |

**SURGE COMPONENTS, INC. AND SUBSIDIARIES**

## Notes to Consolidated Financial Statements

NOTE K – OPERATING LEASE 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 \$180,000 for the year ended November 30, 2019, 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 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 February 29, 2020 are as follows:

Twelve Months Ended February 29,

|      |                   |
|------|-------------------|
| 2021 | \$ 210,838        |
| 2022 | <u>\$ 22,820</u>  |
|      | <u>\$ 233,658</u> |

Net rental expense for the three months ended February 29, 2020 and February 28, 2019 were \$91,678 and \$84,814 respectively, of which \$66,719 and \$65,806 respectively, was paid to the Related Company.

## 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 three customers who each accounted for 20%, 11% and 11% of net sales for the three months ended February 29, 2020 and two customers who accounted for 11% and 14% of net sales for the three months ended February 28, 2019. The Company had two customers who accounted for 20% and 11% of accounts receivable at February 29, 2020 one customer who accounted for 14% of accounts receivable at February 28, 2019.

#### NOTE N – MAJOR SUPPLIERS

During the three months ended February 29, 2020 and February 28, 2019 there was one foreign supplier accounting for 39% and 35% of total inventory purchased.

The Company purchases substantially all of its products overseas. For the three months ended February 29, 2020, the Company purchased 42% of its products from Taiwan, 18% from Hong Kong, 29% from elsewhere in Asia and less than 1% overseas outside of Asia. The Company purchases the balance of its products in the United States.

#### NOTE O – EXPORT SALES

The Company's export sales were as follows:

|                       | <u>Three Months Ended</u>          |                                    |
|-----------------------|------------------------------------|------------------------------------|
|                       | <u>February 29,</u><br><u>2020</u> | <u>February 28,</u><br><u>2019</u> |
| Canada                | 636,417                            | 1,092,398                          |
| China                 | 1,153,406                          | 1,513,169                          |
| Other Asian Countries | 214,762                            | 445,435                            |
| South America         | 115,022                            | 81,621                             |
| Europe                | 283,762                            | 326,913                            |

Revenues are attributed to countries based on location of customer.

#### NOTE P – 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. The duration and intensity of this global health emergency and related disruptions is uncertain. 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 had significantly impacted the Company's customers. The Company has already recorded order cancellations and order hold notices from customers and expects this to continue.

**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 cCronavirus 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 \$76,675 and \$22,029 for the three months ended February 29, 2020 and February 28, 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 to service and further develop the business. For these reasons, we established Surge Ltd., our Asia subsidiary. 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. 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 strongly impacted by the tariffs which are negatively impacting 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 and so the Company has not yet experienced a material adverse effect from the tariffs.

The Coronavirus is impacting all of Asia and Surge Components seriously. Factories in China that produce our products reopened after the Chinese New Year one week late at the mandate of the Chinese government. The factory work force at reopening in February 2020 is now up to 70% - 80% of its normal 100% capacity. We do hope that it will continue to increase over the near term as China is coming out of the virus now. This impacts the manufacturing productivity of the factories, and therefore the amount of inventory we receive, and can ship to customers. 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. Furthermore, we expect our customers in china and elsewhere will reduce their future purchases from us if they are not able to complete the manufacturer of their products due to the shortage of components from other suppliers. The virus will potentially impact the Company’s sales performance in a negative way for the balance of Fiscal 2020, depending on the duration and severity of the virus’ impact on the operations of our vendors and suppliers, and on the global economy as a whole.

### **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 \$34,000.

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 three months ended February 29, 2020 decreased by \$1,618,204 or 19.2%, to \$6,789,138 as compared to net sales of \$8,407,342 for the three months ended February 28, 2019. We attribute the decrease to a decrease in business with new customers as well as additional business with existing customers. We can also attribute the decline in sales to the fact that because due to the impact of the virus in China, we did not receive enough inventory from our suppliers to cover customer orders. This has had an impact on the Company's sales. Net sales for the three months ended February 29, 2020 and February 28, 2019 reflect \$383,368 and \$362,772, respectively of tariff costs that the Company was able to pass on to its customers.

Our gross profit for the three months ended February 29, 2020 decreased by \$437,784 to \$1,885,776, or 18.8%, as compared to \$2,323,560 for the three months ended February 28, 2019. Gross margin as a percentage of net sales remained flat at 27.8% for the three months ended February 29, 2020 compared to 27.6% for the three months ended February 28, 2019. The decrease in gross profit can be attributed to the decrease in sales volume. 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 three months ended February 29, 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. In the first half of 2020, the Company expects the effects of the tariffs to be similar to 2019.

Selling and shipping expenses for the three months ended February 29, 2020 was \$656,838, an increase of \$13,942, or 2.2%, as compared to \$642,896 for the three months ended February 28, 2019. We attribute the increase to increases in selling expenses such as salesman payroll, travel expenses and advertising expenses, offset by a decrease in commission expenses and entertainment expenses.

General and administrative expenses for the three months ended February 29, 2020 was \$1,189,240, an increase of \$102,203, or 9.4%, as compared to \$1,087,037 for the three months ended February 28, 2019. The increase is due primarily to increases in salaries and related payroll tax expenses, rent expenses, general insurance, office expenses, temporary help expenses as well as professional fees and public company expenses, as partially offset by decreases in utilities and computer expenses.

Depreciation expense for the three months ended February 29, 2020 was \$9,364, a decrease of \$214, or 2.2%, as compared to \$9,578 for the three months ended February 28, 2019. The decrease is due the company purchasing less equipment during the three months ended February 29, 2020.

Other income for the three months ended February 29, 2020 was \$518, an increase of \$517 compared to \$1 for the three months ended February 28, 2019. We attribute the increase to the increase in the cash balances for the three months ended February 29, 2020.

Interest expense for the three months ended February 29, 2020 was \$567, a decrease of \$166, or 22.6% compared to \$733 for the three months ended February 28, 2019. We attribute the decrease to the Company not utilizing the line of credit during the three months ended February 29, 2020.

Tax expense for the three months ended February 29, 2020 was \$294,087 an increase \$404,567 as compared to a tax benefit of \$(110,480) for the three months ended February 28, 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 loss for the three months ended February 29, 2020 was \$(263,802), compared to a net income of \$693,797 for the three months ended February 28, 2019.

## Liquidity and Capital Resources

As of February 29, 2020 we had cash of \$3,331,796, and working capital of \$7,248,819. We believe that our working capital levels are adequate to meet our operating requirements during the next twelve months. The Company is exploring and evaluating opportunities for growth and expansion using the Company's cash resources.

During the three months ended February 29, 2020, we had net cash flow provided by operating activities of \$609,712, as compared to net cash flow provided by operating activities of \$63,549 for the three months ended February 28, 2019. The increase in cash flow from operating activities resulted from increases in cash flows provided by accounts receivable, inventory, prepaid expenses and increases in deferred income taxes as partially offset by net loss, and decreases in accounts payable and accrued expenses.

We had net cash flow used in investing activities of \$(15,343) for the three months ended February 29, 2020, as compared to net cash flow used in investing activities of \$(5,580) for the three months ended February 28, 2019. We attribute the change to the Company purchasing more equipment during the three months ended February 29, 2020.

We had net cash flow used in financing activities of \$(1,878) during the three months ended February 29, 2020 as compared to \$(3,311) used in financing activities for the three months ended February 28, 2019. The majority of the change relates to paying down the lease on telephone equipment during the three months ended February 29, 2020.

As a result of the foregoing, the Company had a net increase in cash of \$592,491 for the three months ended February 29, 2020, as compared to a net increase in cash of \$54,658 for the three months ended February 28, 2019.

The table below sets forth our contractual obligations, including long-term debt, operating leases and other long-term obligations, as of February 29, 2020:

| Contractual Obligations       | Total      | Payments due  |                |                |                     |
|-------------------------------|------------|---------------|----------------|----------------|---------------------|
|                               |            | 0 – 12 Months | 13 – 36 Months | 37 – 60 Months | More than 60 Months |
| Financing Lease Obligations   | \$ 23,006  | \$ 7,965      | \$ 15,041      | \$ -           | \$ -                |
| Operating Right of Use Leases | \$ 233,658 | 210,838       | 22,820         | -              | -                   |
| Total obligations             | \$ 256,664 | \$ 218,803    | \$ 37,861      | \$ -           | \$ -                |

## 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 February 29, 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 February 29, 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.**

| <b>Exhibit Number</b> | <b>Description</b>  |
|-----------------------|---|
| 4.1                   | <a href="#">Rights Agreement dated as of October 7, 2016 between Surge Components, Inc., as the Company, and Continental Stock Transfer &amp; 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.</a> |
| 4.2                   | <a href="#">Amendment to the Rights Agreement dated as of October 6, 2019 between Surge Components, Inc., as the Company, and Continental Stock Transfer &amp; Trust Company, as Rights Agent filed with Form 10-Q on October 15, 2019.</a>   |
| 31.1                  | <a href="#">Certification by principal executive officer and principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>  |
| 32.1                  | <a href="#">Certification by principal executive officer and principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>  |
| 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: April 14, 2020

By: /s/ Ira Levy

Name: Ira Levy

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

## 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: April 14, 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 February 29, 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: April 14, 2020

By: /s/ Ira Levy

Ira Levy  
Chief Executive Officer  
(Principal Executive Officer and  
Principal Financial Officer)