

SURGE COMPONENTS INC  
Form 10-Q  
July 15, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For The Quarterly Period Ended May 31, 2014

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

COMMISSION FILE NUMBER 000-27688

SURGE COMPONENTS, INC.

(Exact name of registrant as specified in its charter)

Nevada  
(State or other jurisdiction of  
incorporation or organization)

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

95 East Jefryn Blvd., Deer Park,  
New York  
(Address of principal executive  
offices)

11729  
(Zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Edgar Filing: SURGE COMPONENTS INC - Form 10-Q

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

As of July 15, 2014, there were 9,060,012 outstanding shares of the Registrant's Common Stock, \$.001 par value.

1

---

Table of Contents

SURGE COMPONENTS, INC

TABLE OF CONTENTS

	Page
PART I - FINANCIAL INFORMATION	
<u>Item 1. Financial Statements</u>	3
<u>Consolidated Balance Sheets as of May 31, 2014 (unaudited) and November 30, 2013</u>	3
<u>Consolidated Statements of Income for the six and three months ended May 31, 2014 and May 31, 2013 (unaudited)</u>	5
<u>Consolidated Statements of Cash Flows for the six months ended May 31, 2014 and May 31, 2013 (unaudited)</u>	6
<u>Notes to Consolidated Financial Statements (unaudited)</u>	8
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	24
<u>Item 4. Controls and Procedures</u>	24
PART II - OTHER INFORMATION	
<u>Item 1. Legal Proceedings</u>	25
<u>Item 1A. Risk Factors</u>	25
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	25
<u>Item 3. Defaults Upon Senior Securities</u>	25
<u>Item 4. Mine Safety Disclosures</u>	25
<u>Item 5. Other Information</u>	25
<u>Item 6. Exhibits</u>	25
<u>SIGNATURES</u>	26

Table of Contents

## PART I Financial Information

## ITEM 1. FINANCIAL STATEMENTS.

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets  
(unaudited)

	May 31, 2014	November 30, 2013
ASSETS		
Current assets:		
Cash	\$ 5,373,535	\$ 4,288,090
Accounts receivable - net of allowance for doubtful accounts of \$76,883 and \$60,000	4,386,266	4,963,385
Inventory, net	3,889,033	3,672,563
Prepaid expenses and income taxes	223,805	241,696
Deferred income taxes	318,633	364,152
Total current assets	14,191,272	13,529,886
Fixed assets – net of accumulated depreciation and amortization of \$2,086,304 and \$2,065,539	76,344	75,275
Deferred income taxes	955,898	1,092,455
Other assets	11,652	11,652
Total assets	\$ 15,235,166	\$ 14,709,268

See notes to consolidated financial statements

Table of Contents

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets (unaudited)  
(Continued)

	May 31, 2014	November 30, 2013
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 3,616,987	\$ 3,329,776
Accrued expenses and taxes	742,814	715,102
Accrued salaries	224,759	385,569
<b>Total current liabilities</b>	<b>4,584,560</b>	<b>4,430,447</b>
Deferred rent	38,485	35,855
<b>Total liabilities</b>	<b>4,623,045</b>	<b>4,466,302</b>
Commitments and contingencies		
Shareholders' equity		
Preferred stock - \$.001 par value stock, 5,000,000 shares authorized:		
Series A – 260,000 shares authorized, none outstanding, non-voting, convertible, redeemable.		
Series B – 200,000 shares authorized, none outstanding, voting, convertible, redeemable.		
Series C–100,000 shares authorized, 23,700 and 23,700 shares issued and outstanding, redeemable, convertible, and a liquidation preference of \$5 per share	24	24
Common stock - \$.001 par value stock, 75,000,000 shares authorized, 9,060,012 and 9,060,012 shares issued and outstanding	9,060	9,060
Additional paid-in capital	23,192,425	23,153,177
Accumulated deficit	(12,589,388)	(12,919,295)
<b>Total shareholders' equity</b>	<b>10,612,121</b>	<b>10,242,966</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 15,235,166</b>	<b>\$ 14,709,268</b>

See notes to consolidated financial statements.

Table of Contents

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Statements of Income  
(Unaudited)

	Six Months Ended May 31,		Three Months Ended May 31,	
	2014	2013	2014	2013
Net sales	\$12,928,333	\$11,077,572	\$6,706,624	\$5,891,089
Cost of goods sold	9,494,793	7,856,995	4,978,110	4,223,752
Gross profit	3,433,540	3,220,577	1,728,514	1,667,337
Operating expenses:				
Selling and shipping expenses	1,142,027	1,000,819	617,153	507,853
General and administrative expenses	1,730,372	1,569,275	850,259	790,803
Depreciation and amortization	20,765	24,594	11,094	13,235
Total operating expenses	2,893,164	2,594,688	1,478,506	1,311,891
Income before other income (expense) and income taxes	540,376	625,889	250,008	355,446
Other income(expense):				
Interest expense	-	-	-	-
Investment income	1,744	2,403	1,055	1,614
Other income(expense)	1,744	2,403	1,055	1,614
Income before income taxes	542,120	628,292	251,063	357,060
Income taxes	206,288	46,774	101,121	34,892
Net income	335,832	581,518	149,942	322,168
Dividends on preferred stock	5,925	5,925	-	-
Net income available to common shareholders	\$329,907	\$575,593	\$149,942	\$322,168
Net income per share available to common shareholders:				
Basic	\$.04	\$.06	\$.02	\$.04
Diluted	\$.03	\$.06	\$.02	\$.03
Weighted Shares Outstanding:				
Basic	9,060,012	9,060,012	9,060,012	9,060,012
Diluted	9,713,842	9,667,192	9,713,842	9,667,192

See notes to consolidated financial statements.

5

---

Table of Contents

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows  
(unaudited)

	Six Months Ended	
	May 31, 2014	May 31, 2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 335,832	\$ 581,518
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,765	24,594
Stock compensation expense	39,248	11,622
Deferred income taxes	182,076	20,541
Allowance for doubtful accounts	16,883	8,441
<b>CHANGES IN OPERATING ASSETS AND LIABILITIES:</b>		
Accounts receivable	560,236	(397,836)
Inventory	(216,470)	(813,771)
Prepaid expenses and income taxes	17,891	(48,967)
Other assets	-	(7,999)
Accounts payable	287,211	1,295,911
Deferred rent	2,630	4,251
Accrued expenses	(139,023)	(226,412)
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>1,107,279</b>	<b>451,893</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition of fixed assets	(21,834)	(19,985)
<b>NET CASH FLOWS USED IN INVESTING ACTIVITIES</b>	<b>(21,834)</b>	<b>(19,985)</b>



Table of Contents

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

Consolidated Statements Of Cash Flows  
(Continued)  
(unaudited)

Six Months Ended	
May 31,	May 31,
2014	2013

## CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from exercising stock options	-	-
NET CASH FLOWS PROVIDED BY FINANCING ACTIVITIES	-	-
NET CHANGE IN CASH	1,085,445	431,908
CASH AT BEGINNING OF PERIOD	4,288,090	3,443,964
CASH AT END OF PERIOD	\$ 5,373,535	\$ 3,875,872

## SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Income taxes paid	\$ 206,288	\$ 12,128
Interest paid	\$ -	\$ -

## NONCASH INVESTING AND FINANCING ACTIVITIES:

Accrued dividends on preferred stock	\$ 5,925	\$ 5,925
--------------------------------------	----------	----------

See notes to consolidated financial statements.

Table of Contents

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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

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

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

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

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(1) Principles of Consolidation:

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

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

The results and trends in these interim consolidated financial statements for the six months ended May 31, 2014 and May 31, 2013 may not be representative of those for the full fiscal year or any future periods.

(2) Accounts Receivable:

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

(3) Revenue Recognition:

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

For direct shipments, revenue is recognized when product is shipped from the Company's supplier. The Company has a long term supply agreement with one of its suppliers. The Company purchases the merchandise from the supplier and has the supplier directly ship the merchandise to the customer through a freight forwarder. Title passes to the customer upon the merchandise being received by a freight forwarder. Direct shipments were approximately \$1,564,000 and \$932,000 for the six months ended May 31, 2014 and May 31, 2013 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 \$230,646 and \$354,721 for the six months ended May 31, 2014 and May 31, 2013 respectively.

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

Table of Contents

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(3) Revenue Recognition (continued):

The Company and its subsidiaries currently have agreements with several distributors. These agreements have no provisions for the granting of price concessions. Revenues under these distribution agreements were approximately \$3,379,000 and \$1,234,000 for the six months ended May 31, 2014 and May 31, 2013 respectively.

(4) Inventories:

Inventories, which consist solely of products held for resale, are stated at the lower of cost (first-in, first-out method) or market. Products are included in inventory when the Company obtains title and risk of loss on the products, primarily when shipped from the supplier. Inventory in transit principally from foreign suppliers at May 31, 2014 approximated \$1,757,000. The Company, at May 31, 2014, has a reserve against slow moving and obsolete inventory of \$622,071. 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.

Table of Contents

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(6) Concentration of Credit Risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of accounts receivable. The Company maintains substantially all of its cash balances in a limited number of financial institutions. At May 31, 2014 and November 30, 2013, the Company's uninsured cash balances totaled approximately \$2,692,677, and \$2,713,584, respectively.

(7) Income Taxes:

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

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

The Company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The Company is no longer subject to U.S. federal tax examinations for years before fiscal years ending November 30, 2010, and state tax examinations for years before fiscal years ending November 30, 2009. 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 tax benefits, nor was any interest expense recognized during the six months ended May 31, 2014 and May 31, 2013.

Table of Contents

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(8) Cash Equivalents:

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

(9) Use of Estimates:

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

(10) Marketing and promotional costs:

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

(11) Fair Value of Financial Instruments:

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

Table of Contents

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(12) Shipping Costs

The Company classifies shipping costs as a component of selling expenses. Shipping costs totaled \$6,618 and \$9,639 for the six months ended May 31, 2014 and May 31, 2013 respectively.

(13) Earnings Per Share

Basic earnings per share includes no dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. The difference between reported basic and diluted weighted-average common shares results from the assumption that all dilutive stock options and convertible preferred stock exercised into common stock. Total potentially dilutive shares excluded from diluted weighted shares outstanding at May 31, 2014 and May 31, 2013 totaled 569,608 and 332,820 respectively.

(14) Stock Based Compensation

Stock Based Compensation to Employees

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

Stock Based Compensation to Other than Employees

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

Table of Contents

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

## NOTE C - FIXED ASSETS

Fixed assets consist of the following:

	May 31, 2014	November 30, 2013
Furniture and Fixtures	\$ 322,586	\$ 322,586
Leasehold Improvements	948,589	939,648
Computer Equipment	891,473	878,580
Less-Accumulated Depreciation	(2,086,304)	(2,065,539)
Net Fixed Assets	\$ 76,344	\$ 75,275

Depreciation and amortization expense for the six months ended May 31, 2014 and May 31, 2013 was \$20,765 and \$24,594, respectively.

## NOTE D - ACCRUED EXPENSES

Accrued expenses consist of the following:

	May 31, 2014	November 30, 2013
Commissions	\$ 273,880	\$ 290,745
Preferred Stock Dividends	194,632	188,707
Interest	102,399	102,399
Other accrued expenses	171,903	133,251
	\$ 742,814	\$ 715,102

In March 2000, the Company completed a \$7,000,000 private placement of convertible notes. The face value of the notes was converted into common stock in July 2001 pursuant to the automatic conversion provisions of the notes. However, approval by holders of the notes was required to convert the interest accrued on the notes to common stock. The accrued interest set forth in the Company's financial statements relates to the portion of the accrued interest for which note holder approval was not obtained and therefore not converted into common stock. No additional interest accrues on these amounts and none of the accrued interest was repaid during any of the periods presented.

## NOTE E – RETIREMENT PLAN

In June 1997, the Company adopted a qualified 401(k) retirement plan for all full-time employees who are twenty-one years of age and have completed twelve months of service. The plan allows total employee contributions of up to fifteen percent (15%) of the eligible employee's salary through salary reduction. The Company makes a matching



contribution of twenty percent (20%) of each employee's contribution for each dollar of employee deferral up to five percent (5%) of the employee's salary. Net assets for the plan, as estimated by Union Central, Inc., which maintains the plan's records, were approximately \$978,700 at November 30, 2013. Pension expense for the six months ended May 31, 2014 and May 31, 2013 was \$9,286 and \$3,633, respectively.

Table of Contents

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE F – SHAREHOLDERS’ EQUITY

[1] Preferred Stock:

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

In January 2000, the Company authorized 260,000 shares of preferred stock as Non-Voting Redeemable Convertible Series A Preferred Stock (“Series A Preferred”). None of the Series A preferred stock is outstanding as of May 31, 2014.

In November 2000, the Company authorized 200,000 shares of preferred stock as Voting Redeemable Convertible Series B Preferred Stock (“Series B Preferred”). None of the Series B Preferred Stock is outstanding as of May 31, 2014.

In November 2000, the Company authorized 100,000 shares of preferred stock as Non-Voting Redeemable Convertible Series C Preferred Stock (“Series C Preferred”). Each share of Series C Preferred is automatically convertible into 10 shares of our common stock upon shareholder approval. If the Series C Preferred were converted into common stock on or before April 15, 2001, these shares were entitled to cumulative dividends at the rate of \$.50 per share per annum commencing April 15, 2001 payable on June 30 and December 31 of each year. In November 2000, 70,000 shares of the Series C Preferred were issued in payment of financial consulting services to its investment banker and a shareholder of the Company. In April 2001, 8,000 shares of the Series C Preferred were repurchased and cancelled. Dividends aggregating \$194,632 have not been declared or paid for the semiannual periods ended December 31, 2001 through the semiannual payment due December 31, 2013. The Company has accrued these dividends.

In April 2002, in connection with a Mutual Release, Settlement, Standstill and Non-Disparagement Agreement among other provisions, certain investors transferred back to the Company 252,000 shares of common stock, 19,300 shares of Series C preferred stock, and certain warrants, in exchange for \$225,000. These repurchased shares were cancelled.

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

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

At May 31, 2014 there are 23,700 shares of Series C Preferred issued and outstanding.

Table of Contents

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

## NOTE F – SHAREHOLDERS’ EQUITY (Continued)

## [2] 2010 Incentive Stock Plan

In March 2010, the Company adopted, and in April 2010 the shareholders ratified, the 2010 Incentive Stock Plan (“Stock Plan”). The 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.

Stock Plan activity for the six months ended May 31, 2014 is summarized as follows:

	Shares	Weighted Average Exercise Price
Options outstanding at December 1, 2013	878,000	\$ 0.46
Options issued in the six months ended May 31, 2014	108,438	\$ 0.80
Options exercised in the six months ended May 31, 2014	-	\$ -
Options cancelled in the six months ended May 31, 2014	-	\$ -
Options outstanding at May 31, 2014	986,438	\$ 0.50
Options exercisable at May 31, 2014	986,438	\$ 0.50

## Stock Compensation

On February 25, 2011, the Company granted stock options to employees to purchase 85,000 shares of the Company’s common stock at an exercise price of \$1.15 per share, the value of the common stock on the date of the grant. These options vest over a three year period and expire in ten years. The fair values of these stock options are estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: expected volatility of 60% (based on stock volatility of public company industry peers); average risk-free interest rate of 3.42% (the ten year treasury note rate on the date of the grant); initial expected life of 10 years (based on the term of the options); no expected dividend yield; and amortized over the vesting period.

In July 2012, the Company granted a stock option to one non-officer director to purchase 50,000 shares of common stock at an exercise price of \$0.51 per share, the market price of the common stock on the date of the grant. This option vested immediately and expires in five years. The fair value of this stock option is estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: expected volatility of 35% (based on stock volatility of public company industry peers); average risk-free interest rate of 0.67% (the five year treasury note rate on the date of the grant); initial expected life of 5 years (based on the term of the options) and no expected dividend yield.

In November 2013, the Company granted a stock option to (a) one employee-director and all non-employee directors to purchase 25,000 shares of common stock, and (b) one employee-director to purchase 50,000 shares of common stock, at an exercise price of \$0.82 per share, the market price of the common stock on the date of the grant. These options vested immediately and expire in five years from the grant date. The fair value of these stock options are

estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: expected volatility of 18% (based on the Company's historical stock volatility); average risk-free interest rate of 1.36% (the five year treasury note rate on the date of the grant); initial expected life of 5 years (based on the term of the options) and no expected dividend yield.

In April 2014, the Company granted a stock option to (a) one employee-director to purchase 62,500 shares of common stock, and (b) one employee-director to purchase 45,938 shares of common stock, at an exercise price of \$.80 per share, the market price of the common stock on the date of the grant. These options vest immediately and expire in five years from the grant date. The fair value of these stock options are estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: expected volatility of 20% (based on the Company's historical stock volatility); average risk-free interest rate of 1.65% (the five year treasury note rate on the date of the grant); initial expected life of 5 years (based on the term of the options) and no expected dividend yield.

The intrinsic value of the exercisable options at May 31, 2014 totaled \$324,500. At May 31, 2014 the weighted average remaining life of the stock options is 2.52 years. At May 31, 2014, there was no unrecognized compensation cost related to the stock options granted under the plan.

Table of Contents

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

## NOTE F – SHAREHOLDERS’ EQUITY (Continued)

## [3] Authorized Repurchase:

In November 2002, the Board of Directors authorized the repurchase of up to 1,000,000 Common Shares at a price between \$.04 and \$.045. The Company has not repurchased any shares to date pursuant to such authority.

## [4] Compensation of Directors

In May 2010, the Company issued 12,000 shares of its common stock to each non-officer director as compensation for services on the Board of Directors. These shares were valued at \$0.18 per share, the closing price of the common stock on the over-the-counter market. Starting April 1, 2012, the amount directors each receive for their services on the Board of Directors was increased from \$200 a month to \$2,000 a month. In May 2010, options were granted to each non-officer director to purchase 25,000 shares of common stock at an exercise price of \$0.25 per share. In July 2012, a stock option was granted to one non-officer director to purchase 50,000 shares of common stock at an exercise price of \$0.51 per share. In May 2012, one non-officer director exercised an option and acquired 25,000 shares of common stock for \$6,250. In November 2013, each non-officer director was granted a stock option to purchase 25,000 shares of common stock at an exercise price of \$0.82 per share. In April 2014 one employee-director was granted a stock option to purchase 62,500 shares of common stock at an exercise price of \$0.80 and one employee-director was granted a stock option to purchase 45,938 shares of common stock at an exercise price of \$0.80 per share. (See Note F[2] for disclosure on the valuation and terms of these options). Starting December 1, 2013, the compensation for each non-officer director was increased to \$2,500 per month, and \$3,500 per month for any non-officer director that is the chairman of more than two committees of the Board of Directors.

## NOTE G – INCOME TAXES

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

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

	May 31, 2014	November 30, 2013
Deferred Tax Assets		
Net operating loss	\$ 4,360,949	\$ 4,513,780
Allowance for bad debts	24,327	19,337
Inventory	246,580	233,793
Deferred Rent	15,371	14,320
Depreciation	180,158	180,681
Total deferred tax assets	4,827,385	4,961,911
Valuation allowance	(3,552,854)	(3,505,304)
Deferred Tax Assets	\$ 1,274,531	\$ 1,456,607

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. 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.

Table of Contents

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

## NOTE G – INCOME TAXES (CONTINUED)

The valuation allowance increased by approximately \$47,550 during the six months ended May 31, 2014. This 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.

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

	Six Months Ended	
	May 31, 2014	May 31, 2013
Current:		
Federal	\$ 11,911	\$ 20,538
States	12,301	5,695
	24,212	26,233
Deferred:		
Federal	143,840	16,638
States	38,236	3,903
	182,076	20,541
Provision for income taxes	\$ 206,288	\$ 46,774

The Company files a consolidated income tax return with its wholly-owned subsidiaries and has net operating loss carryforwards of approximately \$11,000,000 for federal and state purposes, which expire through 2020. A reconciliation of the difference between the expected income tax rate using the statutory federal tax rate and the Company's effective rate is as follows:

	Six Months ended	
	May 31, 2014	May 31, 2013
U.S Federal Income tax statutory rate	34%	34%
Valuation allowance	1%	(29)%
State income taxes	2%	2%
Other	1%	-
Effective tax rate	38%	7%

Table of Contents

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

## NOTE H- RENTAL COMMITMENTS

The Company leases its office and warehouse space through 2020 from a corporation that is controlled by officers/shareholders of the Company ("Related Company"). Annual minimum rental payments to the Related Company approximated \$163,000 for the year ended November 30, 2013, 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 May 2013, the Company entered into a lease to rent office space and a warehouse in Hong Kong for two years. Annual minimum rental payments for this space are approximately \$51,200.

The Company's future minimum rental commitments at May 31, 2014 are as follows:

Twelve Months Ended	
May 31,	
2015	\$ 222,082
2016	\$ 178,569
2017	\$ 177,785
2018	\$ 181,341
2019	\$ 184,968
2020 & thereafter	\$ 62,062
	\$ 1,006,807

Net rental expense for the six months ended May 31, 2014 and May 31, 2013 were \$154,086 and \$150,230 respectively, of which \$125,841 and \$134,441 respectively, was paid to the Related Company.



Table of Contents

## SURGE COMPONENTS, INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

## NOTE I – EMPLOYMENT AND OTHER AGREEMENTS

The Company has employment agreements, with terms through July 30, 2014 (renewable on each July 30th for an additional one year period) with two officers of the Company, which provides each with a base salary of \$225,000, subject to certain increases as defined, per annum, plus fringe benefits and bonuses. The Compensation Committee of the Company's Board of Directors determines the bonuses. A bonus pool has been accrued for the two officers through May 31, 2014 totaling \$100,000. The agreements also contain provisions prohibiting the officers from engaging in activities which are competitive with those of the Company during employment and for one year following termination. The agreements further provide that in the event of a change of control, as defined, or a change in ownership of at least 25% of the issued and outstanding stock of the Company, and such issuance was not approved by either officer, or if they are not elected to the Board of Directors of the Company and/or are not elected as an officer of the Company, then the non-approving officer may elect to terminate his employment agreement. If either officer elects to terminate the agreement, he will receive 2.99 times his annual compensation (or such other amount then permitted under the Internal Revenue Code without an excess penalty), in addition to the remainder of his compensation under his existing employment contract. In addition, if the Company makes or receives a "firm commitment" for a public offering of Common Shares, each officer will receive a warrant to purchase, at a nominal value, up to 9.5% of the Company's common stock, provided they do not voluntarily terminate employment.

## NOTE J– MAJOR CUSTOMERS

The Company had one customer who accounted for 17% of net sales for the six months ended May 31, 2014 and one customer who accounted for 11% of net sales for the six months ended May 31, 2013. The Company had one customer who accounted for 18% of accounts receivable at May 31, 2014 and one customer who accounted for 13% of accounts receivable at November 30, 2013.

## NOTE K- MAJOR SUPPLIERS

During the six months ended May 31, 2014 and May 31, 2013, there was one foreign supplier who accounted for 46% and 52% of total inventory purchased.

The Company purchases substantially all of its products overseas. For the six months ended May 31, 2014, the Company purchased 61% of its products from Taiwan, 10% from Hong Kong, 26% from elsewhere in Asia and less than 1% overseas outside of Asia. The Company purchases the balance of its products in the United States.

## NOTE L - EXPORT SALES

The Company's export sales were as follows:

	Six Months Ended	
	May 31, 2014	May 31, 2013
Canada	1,262,290	887,036
China	2,194,262	2,114,106
Other Asian Countries	430,095	375,639

South America	273,164	258,334
Europe	490,036	363,615

Revenues are attributed to countries based on location of customer.

Table of Contents

SURGE COMPONENTS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

NOTE M – LINE OF CREDIT

In June 2011, the Company replaced its existing credit line with a line of credit with a new bank totaling \$1,000,000. Borrowings under the line accrued interest at 2.56% over the LIBOR rate. The line was collateralized by all the Company's assets and included working capital and tangible net worth covenants. The credit line expired in March 2013. The Company did not renew the credit line since it does not believe that such additional funds are required at this time.

Table of Contents

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

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

In some cases, forward-looking statements can be identified by terms such as "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "target," "projects," "contemplates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other similar words. These statements are only predictions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. We discuss many of the risks in greater detail under the heading "Risk Factors" in our Annual Report on Form 10-K. Also, these forward-looking statements represent our estimates and assumptions only as of the date of the filing of this report. Except as required by law, we assume no obligation to update any forward-looking statements 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 will pay 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 \$230,646 and \$354,721 for the six months ended May 31, 2014 and May 31, 2013 respectively.

Challenge engages in the sale of electronic components, including audible components, alarms, chimes and battery related products. Challenge has increased the types of products it sells because some of its suppliers introduced new products, and it has also sourced other products from new suppliers. As a result, we are continually trying to expand our product line. In 2002 we started to import products and sold these under the Challenge name. It started with a line of transducers, and then we added battery snaps, and coin cell holders. Since 2002, we have increased our imported private label product mix to include buzzers, speakers, microphones, resonators, filters, and discriminators. Our suppliers customize many of the products we sell for many customers based on the customers' own designs and those our suppliers redesign for them at our suppliers' factories. We have an experienced design engineer on our staff with thirty years of experience who works with our suppliers on such redesigns. We continue to expand the product mix we sell. We sell these products through independent representatives that earn a commission on the gross sale of the

products we sell in their area. We also are working with local, regional, and national distributors to sell these products to local accounts in every state.

## Table of Contents

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

The electronic components industry is in constant flux, changing, from one of strong demand to one of moderate demand. Management expects the remainder of 2014 to continue with the moderate demand for components that it experienced in 2013 and the first half of 2014. Due to this worldwide moderate to strong demand, the Company could feel the effects of potential shortages of materials and price escalation.

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

### 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 factory to our customer, revenue is recognized when product is shipped from the Company's supplier. The Company acts as a sales agent for certain customers buying direct from one of its suppliers. The Company reports these commissions as revenues in the period earned.

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

#### Inventory Valuation

Inventories are recorded at the lower of cost or market. Write-downs of inventories to market value are based on stock rotation, historical sales requirements and obsolescence as well as in the changes in the backlog. Reserves required for obsolescence were not material in any of the periods in the financial statements presented. If market conditions are less favorable than those projected by management, additional write-downs of inventories could be required. For example, each additional 1% of obsolete inventory would reduce operating income by approximately \$39,000.

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

### Comparison of six and three months ended May 31, 2014 and May 31, 2013

Consolidated net sales for the six months ended May 31, 2014 increased by \$1,850,761 or 17%, to \$12,928,333 as compared to net sales of \$11,077,572 for the six months ended May 31, 2013. Consolidated net sales for the three months ended May 31, 2014 increased by \$815,535 or 14% to \$6,706,624 as compared to net sales of \$5,891,089 for the three months ended May 31, 2013. We largely attribute the increase in net sales to the inclusion of one of our parts in an existing customer's product line introduced in November 2013. There is no assurance that the customer will continue this product line or that the customer will continue to purchase components for the product line from us. We also attribute the increase to an increase in business with new customers and increases in sales by three of the Company's distributors whose sales were lower during the six months ended May 31, 2013.

Our gross profit for the six months ended May 31, 2014 was \$3,433,540, an increase of \$212,963, or 7%, as compared to \$3,220,577 for the six months ended May 31, 2013. Gross profit for the three months ended May 31, 2014 was \$1,728,514, an increase of \$61,177, or 4%, as compared to \$1,667,337 for the three months ended May 31, 2013. Gross profit as a percentage of net sales, or profit margin, decreased to 26.6% for the six months ended May 31, 2014 compared to 29.1% for the six months ended May 31, 2013. Gross profit as a percentage of net sales, or profit margin, decreased to 25.8% for the three months ended May 31, 2014 compared to 28.3% for the three months ended May 31, 2013. The Company attributes the increase in gross profit to the increase in sales. The decrease in profit margin can be attributed to a high volume of sales to certain customers for products with a lower gross profit margin in the six months ended May 31, 2014 as compared to the six months ended May 31, 2013. Furthermore, there are certain customers with whom the Company has an agreement to provide periodic cost reductions. The level of the reduction is only known after negotiation is completed each period, and only affects products shipping from that point forward, and does not affect any of the customers existing orders.

Table of Contents

Selling and shipping expenses for the six months ended May 31, 2014 was \$1,142,027, an increase of \$141,208, or 14%, as compared to \$1,000,819 for the six months ended May 31, 2013. Selling and shipping expenses for the three months ended May 31, 2014 was \$617,153, an increase of \$109,300, or 22%, as compared to \$507,853 for the three months ended May 31, 2013. The increase for the six months ended May 31, 2014 was due to an increase in sales commissions, travel expenses, and auto expenses, offset by a decrease in salesman payroll, freight out expenses and shipping expenses. The increase for the three months ended May 31, 2014 is due to an increase in commission expenses, salesman payroll, primarily due to the Company hiring a national sales manager, and travel expenses, offset by a decrease in advertising and freight out expenses.

General and administrative expenses for the six months ended May 31, 2014 was \$1,730,372, an increase of \$161,097, or 10%, as compared to \$1,569,275 for the six months ended May 31, 2013. General and administrative expenses for the three months ended May 31, 2014 was \$850,259, an increase of \$59,456, or 8%, as compared to \$790,803 for the three months ended May 31, 2013. The increase for the six months ended May 31, 2014 is due to the increase in office expenses, professional fees, computer expense, salaries and related payroll taxes, allowance for doubtful accounts, general and health insurance expenses and an increase in directors fees that took effect in December 2013 as partially offset by the reduction in warehouse and maintenance expenses. The increase for the three months ended May 31, 2014 is due to an increase in rent expenses, health insurance expenses, computer expenses, professional fees and directors fees offset by a decrease in salaries.

Depreciation expense for the six months ended May 31, 2014 was \$20,765, a decrease of \$3,829 or 16%, as compared to \$24,594 for the six months ended May 31, 2013. Depreciation expense for the three months ended May 31, 2014 was \$11,094, a decrease of \$2,141 or 16%, as compared to \$13,235 for the three months ended May 31, 2013. The decrease is due to assets becoming fully depreciated.

Income tax expense for the six months ended May 31, 2014 was \$206,288, an increase of \$159,514, or 341% as compared to \$46,774 for the six months ended May 31, 2013. Income tax expense for the three months ended May 31, 2014 was \$101,121, an increase of \$66,229, or 190% as compared to \$34,892 for the three months ended May 31, 2013. The increase is a result of management's revised estimate of future taxable income and the related impact on the reported deferred tax, primarily net operating losses. This change in the valuation allowance is based on management's estimates of future taxable income. The degree of variability inherent in the estimates of future taxable income is significant and subject to change in the near term. The Company reviews its estimates of future taxable income in each reporting period and adjustments to the valuation allowance are non-cash transactions reflected in the current operations.

As a result of the foregoing, net income for the six months ended May 31, 2014 was \$335,832, compared to the net income of \$581,518 for the six months ended May 31, 2013. Net income for the three months ended May 31, 2014 was \$149,942, compared to the net income of \$322,168 for the six months ended May 31, 2013.

Liquidity and Capital Resources

As of May 31, 2014 we had cash of \$5,373,535, and working capital of \$9,606,712. We believe that our working capital levels are adequate to meet our operating requirements during the next twelve months.

We had net cash flow provided by operating activities of \$1,107,279 for the six months ended May 31, 2014, as compared to net cash flow provided by operating activities of \$451,893 for the six months ended May 31, 2013. The increase in cash flow from operating activities resulted from increases in accounts payable, as well as decreases in accounts receivable, accounts payable, prepaid expenses, deferred income taxes, accrued expenses and salaries.



We had net cash flow used in investing activities of \$(21,834) for the six months ended May 31, 2014, as compared to net cash flow used in investing activities of \$(19,985) for the six months ended May 31, 2013. The increase is due to purchasing additional computer equipment.

As a result of the foregoing, the Company had a net increase in cash of \$1,085,445 for the six months ended May 31, 2014, as compared to a net increase in cash of \$431,908 for the six months ended May 31, 2013.

In June 2011, the Company replaced its existing credit line with a line of credit with JP Morgan Chase Bank totaling \$1,000,000. Borrowings under the line accrued interest at 2.56% over the LIBOR rate. The line was collateralized by all the Company's assets and included working capital and tangible net worth covenants. The credit line expired in March 2013. The Company did not renew the credit line since it does not believe such additional funds are required at this time.

Table of Contents

The Company intends to maintain its current cash along with cash generated from operations to fund its current operations and to execute its plans, which may include potential merger and acquisition activities and investments to expand the Company's core businesses.

The table below sets forth our contractual obligations, including long-term debt, operating leases and other long-term obligations, as of May 31, 2014.

Contractual Obligations	Total	Payments due			
		0 – 12 Months	13 – 36 Months	37 – 60 Months	More than 60 Months
Long-term debt	\$ -	\$ --	\$ --	\$ --	\$ --
Operating leases	\$ 1,006,807	222,082	356,354	366,309	62,062
Employment agreements	\$ 75,000	75,000	--	--	--
<b>Total obligations</b>	<b>\$ 1,081,807</b>	<b>\$ 297,082</b>	<b>\$ 356,354</b>	<b>\$ 366,309</b>	<b>\$ 62,062</b>

## Inflation

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

## Off Balance Sheet Arrangements

We do not have any off balance sheet arrangements.

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

Not Applicable.

## ITEM 4. CONTROLS AND PROCEDURES.

## Evaluation of Disclosure Controls and Procedures

The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934, as amended ("Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission ("Commission"). Ira Levy, the Company's principal executive officer and principal financial officer has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of May 31, 2014 and has concluded that, as of such date, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported with the time periods specified in the Commission's rules and forms.

## Changes in Internal Controls

During the six months ended May 31, 2014, 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.



Table of Contents

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

\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

Table of Contents

SIGNATURES

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

SURGE COMPONENTS, INC.

Date: July 15, 2014

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