

USAR
INC.

**ANNUAL
REPORT
2016**

TSR AT A GLANCE

TSR is engaged in the business of providing contract computer programming services to its customers. The Company provides its customers with technical computer personnel to supplement their in-house information technology (“IT”) capabilities. TSR’s customers for its contract computer programming services consist primarily of Fortune 1000 companies with significant technology budgets. With more than 40 years experience in the information services business, TSR is positioned to fulfill virtually any information technology temporary staffing contract requirement. Extensive recruiting efforts are employed to create and maintain a database of highly qualified professionals who are well-versed in the latest technological advances. TSR’s professional staff has extensive experience across a broad range of industries from telecommunications and pharmaceuticals to banking and insurance.

FINANCIAL HIGHLIGHTS

(Amounts in Thousands, Except Per Share Data)

	May 31, <u>2016</u>	May 31, <u>2015</u>	May 31, <u>2014</u>	May 31, <u>2013</u>	May 31, <u>2012</u>
Revenue, Net.....	\$ 60,998	\$ 57,403	\$ 49,530	\$ 44,914	\$ 45,215
Income (Loss) From Operations	839	432	25	(716)	(2)
Net Income (Loss) Attributable to TSR, Inc.	399	193	(86)	(520)	(62)
Basic Net Income (Loss) Per TSR, Inc. Common Share	0.20	0.10	(0.04)	(0.26)	(0.03)
Working Capital.....	9,391	8,986	8,706	8,717	12,402
Total Assets.....	14,090	14,051	13,563	13,619	17,165
Total TSR, Inc. Equity	9,432	9,033	8,840	8,926	12,498
Book Value Per TSR, Inc. Common Share	4.81	4.60	4.51	4.55	6.30
(Total TSR Equity Divided by Common Shares Outstanding)					
Cash Dividends Declared Per TSR, Inc. Common Share	\$ 0.00	\$ 0.00	\$ 0.00	\$ 1.50	\$ 0.00

LETTER FROM THE CHAIRMAN

Dear Stockholders:

The past year marked a challenging stretch for businesses and investors alike. Against this demanding backdrop, I am pleased to report that TSR continued to yield profitable results from our multi-year strategic investment initiative in our people and processes. For the year ended May 31st, 2016, revenue increased 6.3% from last year to \$61.0 million. Net income attributable to TSR increased from \$193,000 in the prior year to net income of \$399,000 in the current year. Additionally, net income per share increased from \$0.10 to \$0.20 per share.

We attribute the increase in revenue largely to two encouraging dynamics. First, the capabilities of our salesforce and technical recruiters – after several years as new hires – have started to mature and blossom. Our focus on organic growth has been another critical driver, with our marketing efforts fixed primarily on increasing business from our existing clients, many of whom we have served for decades.

While we have experienced increases in revenue and profitability, there continue to be new challenges. Rapidly changing computer technologies and evolving standards are the new normal of the IT business world. This means finding and hiring the right IT talent for our clients is requiring ever greater effort and investment. Speed to market matters: “It’s the fast fish which eats the slow fish.”

Another on-going challenge we face (along with the rest of the business world) is that the cost of our health insurance and other employee benefits continues to increase, primarily due to government mandates.

In sum, TSR’s strong culture is built on a foundation of trust, service and hard work. The days are long, often stretching into nights and weekends. Yet we remain relentless in our dedication to listening closely to our customers and their needs, and working smartly on their behalf. We hope and believe that our dedication will also best serve you, our shareholders.

As always, I thank you for your ongoing support.

Sincerely



Joe Hughes

TSR INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
May 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 4,514,157	\$ 3,669,790
Certificates of deposit and marketable securities	1,553,272	1,271,568
Accounts receivable:		
Trade, net of allowance for doubtful accounts of \$185,000 in 2016 and \$193,000 in 2015	7,703,680	8,754,784
Other	<u>10,853</u>	<u>2,458</u>
	7,714,533	8,757,242
Prepaid expenses	99,069	116,096
Deferred income taxes	<u>128,000</u>	<u>120,000</u>
Total Current Assets.....	<u>14,009,031</u>	<u>13,934,696</u>
Equipment and leasehold improvements, at cost:		
Equipment.....	99,244	102,833
Furniture and fixtures.....	111,107	111,107
Automobiles.....	19,665	19,665
Leasehold improvements	<u>60,058</u>	<u>60,058</u>
	290,074	293,663
Less accumulated depreciation and amortization.....	<u>262,076</u>	<u>254,732</u>
	27,998	38,931
Other assets	49,653	49,653
Deferred income taxes	<u>3,000</u>	<u>28,000</u>
Total Assets.....	\$ <u>14,089,682</u>	\$ <u>14,051,280</u>
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts and other payables.....	\$ <u>723,705</u>	\$ <u>1,129,105</u>
Accrued expenses and other current liabilities:		
Salaries, wages and commissions	2,481,436	2,237,628
Other	<u>152,674</u>	<u>146,214</u>
	2,634,110	2,383,842
Income taxes payable.....	14,810	3,877
Advances from customers.....	<u>1,245,563</u>	<u>1,431,522</u>
Total Liabilities	<u>4,618,188</u>	<u>4,948,346</u>
Commitments and contingencies		
Equity:		
TSR, Inc.		
Preferred stock, \$1.00 par value, authorized 500,000 shares; none issued	-	-
Common stock, \$0.01 par value, authorized 12,500,000 shares; issued 3,114,163 shares; 1,962,062 outstanding	31,142	31,142
Additional paid-in capital	5,102,868	5,102,868
Retained earnings.....	<u>17,811,884</u>	<u>17,412,658</u>
	22,945,894	22,546,668
Less: Treasury stock, 1,152,101 shares, at cost	<u>13,514,003</u>	<u>13,514,003</u>
Total TSR, Inc. Equity.....	9,431,891	9,032,665
Noncontrolling Interest	39,603	70,269
Total Equity.....	<u>9,471,494</u>	<u>9,102,934</u>
Total Liabilities and Equity	\$ <u>14,089,682</u>	\$ <u>14,051,280</u>

TSR INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
Years ended May 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Revenue, net	\$ <u>60,998,281</u>	\$ <u>57,402,896</u>
Cost of sales	<u>51,038,879</u>	48,087,428
Selling, general and administrative expenses	<u>9,120,526</u>	<u>8,883,003</u>
	<u>60,159,405</u>	<u>56,970,431</u>
Income from operations	<u>838,876</u>	<u>432,465</u>
Other income:		
Interest and dividend income	8,621	6,114
Unrealized gain (loss) from marketable securities, net	<u>(2,296)</u>	<u>5,712</u>
	<u>6,325</u>	<u>11,826</u>
Income before income taxes	845,201	444,291
Provision for income taxes	<u>389,000</u>	<u>152,000</u>
Consolidated net income	456,201	292,291
Less: Net income attributable to noncontrolling interest	<u>56,975</u>	<u>99,580</u>
Net income attributable to TSR, Inc.	\$ <u>399,226</u>	\$ <u>192,711</u>
Net income per TSR, Inc. common share	\$ <u>0.20</u>	\$ <u>0.10</u>
Weighted average number of common shares outstanding.....	<u>1,962,062</u>	<u>1,962,062</u>

TSR INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY
Years ended May 31, 2016 and 2015

	Shares of common stock	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	TSR Inc. equity	Non- controlling interest	Total equity
Balance at June 1, 2014	3,114,163	\$ 31,142	\$ 5,102,868	\$17,219,947	\$(13,514,003)	\$ 8,839,954	\$ 80,124	\$ 8,920,078
Net income attributable to noncontrolling interest.....	-	-	-	-	-	-	99,580	99,580
Distribution to noncontrolling interest.....	-	-	-	-	-	-	(109,435)	(109,435)
Net income attributable to TSR, Inc.	<u>-</u>	<u>-</u>	<u>-</u>	<u>192,711</u>	<u>-</u>	<u>192,711</u>	<u>-</u>	<u>192,711</u>
Balance at May 31, 2015.....	3,114,163	31,142	5,102,868	17,412,658	(13,514,003)	9,032,665	70,269	9,102,934
Net income attributable to noncontrolling interest.....	-	-	-	-	-	-	56,975	56,975
Distribution to noncontrolling interest.....	-	-	-	-	-	-	(87,641)	(87,641)
Net income attributable to TSR, Inc.	<u>-</u>	<u>-</u>	<u>-</u>	<u>399,226</u>	<u>-</u>	<u>399,226</u>	<u>-</u>	<u>399,226</u>
Balance at May 31, 2016.....	<u>3,114,163</u>	<u>\$ 31,142</u>	<u>\$ 5,102,868</u>	<u>\$17,811,884</u>	<u>\$(13,514,003)</u>	<u>\$ 9,431,891</u>	<u>\$ 39,603</u>	<u>\$ 9,471,494</u>

TSR INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended May 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Consolidated net income	\$ 456,201	\$ 292,291
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization	22,765	20,428
Provision for bad debts.....	15,000	-
Unrealized (gain) loss from marketable securities, net	2,296	(5,712)
Deferred income taxes.....	17,000	68,000
Changes in operating assets and liabilities:		
Accounts receivable-trade	1,036,104	35,554
Other receivables.....	(8,395)	6,872
Prepaid expenses	17,027	(41,908)
Prepaid and recoverable income taxes	-	32,159
Accounts and other payables and accrued expenses and other current liabilities.....	(155,132)	362,385
Income taxes payable	10,933	3,877
Advances from customers	<u>(185,959)</u>	<u>(60,424)</u>
Net cash provided by operating activities	<u>1,227,840</u>	<u>713,522</u>
Cash flows from investing activities:		
Proceeds from maturities of marketable securities	1,762,000	2,487,000
Purchases of marketable securities.....	(2,046,000)	(2,238,000)
Purchases of equipment and leasehold improvements	<u>(11,832)</u>	<u>(25,264)</u>
Net cash provided by (used in) investing activities	<u>(295,832)</u>	<u>223,736</u>
Cash flows from financing activities:		
Distributions to noncontrolling interest.....	<u>(87,641)</u>	<u>(109,435)</u>
Net cash used in financing activities	<u>(87,641)</u>	<u>(109,435)</u>
Net increase in cash and cash equivalents.....	844,367	827,823
Cash and cash equivalents at beginning of year	<u>3,669,790</u>	<u>2,841,967</u>
Cash and cash equivalents at end of year.....	<u>\$ 4,514,157</u>	<u>\$ 3,669,790</u>
Supplemental disclosures of cash flow data:		
Income taxes paid.....	<u>\$ 361,000</u>	<u>\$ 49,000</u>

TSR INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
May 31, 2016 and 2015

(1) Summary of Significant Accounting Policies

(a) Business, Nature of Operations and Customer Concentrations

TSR, Inc. and Subsidiaries (the “Company”) are primarily engaged in providing contract computer programming services to commercial customers located primarily in the Metropolitan New York area. The Company provides its customers with technical computer personnel to supplement their in-house information technology capabilities. In fiscal 2016, four customers each accounted for more than 10% of the Company’s consolidated revenue, constituting a combined 55.0%. The largest of these constituted 17.7% of consolidated revenue. In fiscal 2015, two customers each accounted for more than 10% of the Company’s consolidated revenue, constituting a combined 34.9%. The largest of these constituted 19.2% of consolidated revenue. The accounts receivable balances associated with the Company’s largest customers were \$3,735,000 for four customers at May 31, 2016 and \$2,109,000 for two customers at May 31, 2015. The Company operates in one business segment, computer programming services.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of TSR, Inc. and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

(c) Revenue Recognition

The Company’s contract computer programming services are generally provided under time and materials arrangements with its customers. Revenue is recognized in accordance with Accounting Standards Codification (“ASC”) Topic 605, “Revenue Recognition”, when persuasive evidence of an arrangement exists, the services have been rendered, the price is fixed or determinable, and collectability is reasonably assured. These conditions occur when a customer agreement is effected and the consultant performs the authorized services. Revenue is recorded net of all discounts and processing fees. Advances from customers represent amounts received from customers prior to the Company’s completion of the related services and credit balances from overpayments.

Reimbursements received by the Company for out-of-pocket expenses are characterized as revenue.

(d) Cash and Cash Equivalents

The Company considers short-term highly liquid investments with maturities of three months or less at the time of purchase to be cash equivalents. Cash and cash equivalents were comprised of the following as of May 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Cash in banks	\$ <u>3,974,007</u>	\$ 2,851,802
Money market funds.....	<u>540,150</u>	<u>817,988</u>
	<u>\$ 4,514,157</u>	<u>\$ 3,669,790</u>

(e) Certificates of Deposit and Marketable Securities

The Company has characterized its investments in marketable securities, based on the priority of the inputs used to value the investments, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1), and lowest priority to unobservable inputs (Level 3). If the inputs used to measure the investments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Investments recorded in the accompanying consolidated balance sheets are categorized based on the inputs to valuation techniques as follows:

Level 1 - These are investments where values are based on unadjusted quoted prices for identical assets in an active market the Company has the ability to access.

Level 2 - These are investments where values are based on quoted market prices that are not active or model derived valuations in which all significant inputs are observable in active markets.

Level 3 - These are investments where values are derived from techniques in which one or more significant inputs are unobservable.

TSR INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
May 31, 2016 and 2015

The following are the major categories of assets measured at fair value on a recurring basis as of May 31, 2016 and 2015 using quoted prices in active markets for identical assets (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3):

May 31, 2016	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Certificates of deposit.....	\$ -	\$ 1,528,000	\$ -	\$ 1,528,000
Equity securities	<u>25,272</u>	<u>-</u>	<u>-</u>	<u>25,272</u>
	<u>\$ 25,272</u>	<u>\$ 1,528,000</u>	<u>\$ -</u>	<u>\$ 1,553,272</u>
May 31, 2015	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Certificates of deposit.....	\$ -	\$ 1,244,000	\$ -	\$ 1,244,000
Equity securities	<u>27,568</u>	<u>-</u>	<u>-</u>	<u>27,568</u>
	<u>\$ 27,568</u>	<u>\$ 1,244,000</u>	<u>\$ -</u>	<u>\$ 1,271,568</u>

Based upon the Company's intent and ability to hold its certificates of deposits to maturity (which maturities range up to twelve months at purchase), such securities have been classified as held-to-maturity and are carried at amortized cost, which approximates market value. The Company's equity securities are classified as trading securities, which are carried at fair value, as determined by quoted market prices, which is a Level 1 input, as established by the fair value hierarchy. The related unrealized gains and losses are included in earnings. The Company's certificates of deposit and marketable securities at May 31, 2016 and 2015 are summarized as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Holding Gains</u>	<u>Gross Unrealized Holding Losses</u>	<u>Recorded Value</u>
<u>Current</u>				
2016: Certificates of deposit	\$ 1,528,000	\$ -	\$ -	\$ 1,528,000
Equity securities	<u>16,866</u>	<u>8,406</u>	<u>-</u>	<u>25,272</u>
	<u>\$ 1,544,866</u>	<u>\$ 8,406</u>	<u>\$ -</u>	<u>\$ 1,553,272</u>
2015: Certificates of deposit.....	\$ 1,244,000	\$ -	\$ -	\$ 1,244,000
Equity securities	<u>16,866</u>	<u>10,702</u>	<u>-</u>	<u>27,568</u>
	<u>\$ 1,260,866</u>	<u>\$ 10,702</u>	<u>\$ -</u>	<u>\$ 1,271,568</u>

The Company's investments in marketable securities consist primarily of investments in certificates of deposit and equity securities. Market values were determined for each individual security in the investment portfolio. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as length of time and extent to which fair value has been below cost basis, the financial condition of the issuer, and the Company's ability and intent to hold the investment for a period of time, which may be sufficient for anticipated recovery in market values.

(f) Accounts Receivable and Credit Policies:

The carrying amount of accounts receivable is reduced by a valuation allowance that reflects management's best estimate of the amounts that will not be collected. In addition to reviewing delinquent accounts receivable, management considers many factors in estimating its general allowance, including historical data, experience, customer types, creditworthiness and economic trends. From time to time, management may adjust its assumptions for anticipated changes in any of those or other factors expected to affect collectability.

TSR INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
May 31, 2016 and 2015

(g) Depreciation and Amortization

Depreciation and amortization of equipment and leasehold improvements has been computed using the straight-line method over the following useful lives:

Equipment.....	3 years
Furniture and fixtures	3 years
Automobiles.....	3 years
Leasehold improvements	Lesser of lease term or useful life

(h) Net Income Per Common Share

Basic net income per common share is computed by dividing income available to common stockholders of TSR, Inc. by the weighted average number of common shares outstanding. The Company had no stock options or other common stock equivalents outstanding during the fiscal years ended May 31, 2016 or 2015.

(i) Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial reporting and tax bases of the Company's assets and liabilities at enacted rates expected to be in effect when such amounts are realized or settled. The effect of enacted tax law or rate changes is reflected in income in the period of enactment.

(j) Fair Value of Financial Instruments

ASC Topic 825, "Financial Instruments", requires disclosure of the fair value of certain financial instruments. For cash and cash equivalents, accounts receivable, accounts and other payables, accrued liabilities and advances from customers, the amounts presented in the consolidated financial statements approximate fair value because of the short-term maturities of these instruments.

(k) 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. Such estimates include, but are not limited to provisions for doubtful accounts receivable and assessments of the recoverability of the Company's deferred tax assets. Actual results could differ from those estimates.

(l) Long-Lived Assets

The Company reviews its long-lived assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the sum of the expected cash flows undiscounted and without interest, is less than the carrying amount of the asset, an impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its fair value.

(m) Impact of New Accounting Standards

In May 2014, the FASB issued an update to ASC 606, "Revenue from Contracts with Customers." This update to ASC 606 provides a five-step process to determine when and how revenue is recognized. The core principle of the guidance is that a Company should recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration to be received in exchange for those goods or services. This update to ASC 606 will also result in enhanced disclosures about revenue, providing guidance for transactions that were not previously addressed comprehensively, and improving guidance for multiple-element arrangements. This update to ASC 606 is effective for the Company in the fiscal year ending May 31, 2018. The Company expects the impact of the update, if any, to be immaterial on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes," which applies to the classification of deferred tax assets and liabilities. The update eliminates the requirement to classify deferred tax assets and liabilities as noncurrent or current within a classified statement of financial position. This ASU is effective for annual and interim periods beginning after December 15, 2016 and should be applied prospectively with early adoption permitted at the beginning of an interim or annual reporting period. The Company is currently evaluating the impact of adopting this guidance.

TSR INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
May 31, 2016 and 2015

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities.” The amendments in this update require all equity investments to be measured at fair value with changes in the fair value recognized through net income. The amendments in this update also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, the amendments in this update eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities and the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet for public business entities. This update is effective for the Company in the fiscal year ending May 31, 2019. The Company is currently evaluating the impact, if any, of this update on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842).” This update includes a lease accounting model that recognizes two types of leases – finance leases and operating leases. The standard requires that a lessee recognize on the balance sheet assets and liabilities relating to leases with terms of more than 12 months. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as a finance or operating lease. This update is effective for the Company in the fiscal year ending May 31, 2020. The Company is currently evaluating the impact, if any, of this update on its consolidated financial statements.

(n) Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, certificates of deposit, marketable securities and accounts receivable. The Company places its cash equivalents with high-credit quality financial institutions and brokerage houses. The Company has substantially all of its cash in four bank accounts. At times, such amounts may exceed Federally insured limits. The Company holds its marketable securities in brokerage accounts. The Company has not experienced losses in any such accounts. The Company’s accounts receivable represent 46 accounts with open balances as of May 31, 2016. As a percentage of revenue, the four largest customers among these 46 accounts consisted of 48.5% of the net accounts receivable balance at May 31, 2016.

(2) Income Taxes

A reconciliation of the provision for income taxes computed at the Federal statutory rates for fiscal 2016 and 2015 to the reported amounts is as follows:

	2016		2015	
	Amount	%	Amount	%
Amounts at statutory Federal tax rate.....	\$ 287,000	34.0%	\$ 151,000	34.0%
Noncontrolling interest.....	(19,000)	(2.3)	(34,000)	(7.6)
State and local taxes, net of Federal income tax effect	88,000	10.4	13,000	2.9
Non-deductible expenses and other.....	<u>33,000</u>	<u>3.9</u>	<u>22,000</u>	<u>4.9</u>
	<u>\$ 389,000</u>	<u>46.0%</u>	<u>\$ 152,000</u>	<u>34.2%</u>

The components of the provision for income taxes are as follows:

	Federal	State	Total
2016:			
Current	\$ 253,000	\$ 119,000	\$ 372,000
Deferred	<u>3,000</u>	<u>14,000</u>	<u>17,000</u>
	<u>\$ 256,000</u>	<u>\$ 133,000</u>	<u>\$ 389,000</u>
2015:			
Current.....	\$ 32,000	\$ 52,000	\$ 84,000
Deferred.....	<u>100,000</u>	<u>(32,000)</u>	<u>68,000</u>
	<u>\$ 132,000</u>	<u>\$ 20,000</u>	<u>\$ 152,000</u>

TSR INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
May 31, 2016 and 2015

The tax effects of temporary differences that give rise to significant portions of the deferred income tax assets at May 31, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
Allowance for doubtful accounts receivable.....	\$ 78,000	\$ 86,000
Accrued compensation and other accrued expenses.....	50,000	34,000
Net operating loss carryforward	10,000	25,000
Equipment and leasehold improvement depreciation and amortization.....	(6,000)	1,000
Acquired client relationships	2,000	5,000
Unrealized gains	<u>(3,000)</u>	<u>(3,000)</u>
Total deferred income tax assets.....	\$ <u>131,000</u>	\$ <u>148,000</u>

The Company believes that it is more likely than not that it will realize the benefits of its deferred tax assets based primarily on the Company's history of and projections for taxable income in the future.

The Company has no unrecognized tax benefits at May 31, 2016 and 2015. The Company's Federal and state income tax returns prior to fiscal year 2013 are closed.

The Company recognizes interest and penalties associated with tax matters as selling, general and administrative expenses and includes accrued interest and penalties with accrued and other liabilities in the consolidated balance sheets.

(3) Commitments and Contingencies

A summary of noncancellable long-term operating lease commitments for facilities as of May 31, 2016 follows:

<u>Fiscal Year</u>	<u>Amount</u>
2017.....	\$ 363,000
2018.....	248,000
2019.....	191,000
2020.....	86,000
2021.....	<u>51,000</u>
Total	\$ <u>939,000</u>

Total rent expenses under all lease agreements amounted to \$379,000 and \$390,000 in fiscal 2016 and 2015, respectively.

The Company has entered into employment agreements with two of its officers expiring through 2020. The total remaining payments under these agreements is \$1,225,000 at May 31, 2016.

From time to time, the Company is party to various lawsuits, some involving substantial amounts. Management is not aware of any lawsuits that would have a material adverse impact on the consolidated financial position of the Company.

(4) Stockholder's Equity

During the years ended May 31, 2016 and 2015, the Company did not purchase any of its common stock on the open market under the previously announced plan. As of April 7, 2016, the previously announced plan was terminated with 56,318 shares remaining available for purchase.

TSR INC. AND SUBSIDIARIES
**MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS**

The following discussion and analysis should be read in conjunction with the Company’s consolidated financial statements and notes thereto presented elsewhere in this report.

Results of Operations

The following table sets forth for the periods indicated certain financial information derived from the Company’s consolidated statements of income. There can be no assurance that historical trends in operating results will continue in the future:

	Year Ended May 31, (Dollar Amounts in Thousands)			
	<u>2016</u>		<u>2015</u>	
	<u>Amount</u>	<u>% of Revenue</u>	<u>Amount</u>	<u>% of Revenue</u>
Revenue, Net	\$ 60,998	100.0%	\$ 57,403	100.0%
Cost of Sales	<u>51,039</u>	<u>83.7</u>	<u>48,088</u>	<u>83.8</u>
Gross Profit.....	9,959	16.3	9,315	16.2
Selling, General and Administrative Expenses.....	<u>9,120</u>	<u>14.9</u>	<u>8,883</u>	<u>15.5</u>
Income from Operations	839	1.4	432	0.7
Other Income, Net	<u>6</u>	<u>0.0</u>	<u>12</u>	<u>0.1</u>
Income Before Income Taxes	845	1.4	444	0.8
Provision for Income Taxes	<u>389</u>	<u>0.6</u>	<u>152</u>	<u>0.3</u>
Consolidated Net Income	456	0.8	292	0.5
Net Income Attributable to Noncontrolling Interest	<u>57</u>	<u>0.1</u>	<u>99</u>	<u>0.2</u>
Net Income Attributable to TSR, Inc.....	<u>\$ 399</u>	<u>0.7%</u>	<u>\$ 193</u>	<u>0.3%</u>

Revenue

Revenue consists primarily of revenue from computer programming consulting services. Revenue for the fiscal year ended May 31, 2016 increased \$3,595,000 or 6.3% from fiscal 2015. This increase in revenue resulted primarily from the average daily rates charged for the consultants on billing with customers increasing approximately 5.5% in the current year compared with the prior fiscal year. This rate increase is primarily the result of placing more consultants in higher level positions. The increase in revenue also resulted from the average number of consultants on billing with customers increasing from approximately 346 for the fiscal year ended May 31, 2015 to approximately 350 for the fiscal year ended May 31, 2016.

Cost of Sales

Cost of sales for the fiscal year ended May 31, 2016 increased \$2,951,000 or 6.1% to \$51,039,000 from \$48,088,000 in the prior fiscal year. The increase in cost of sales resulted primarily from the average daily rates paid to the consultants on billing with customers increasing approximately 4.5% in the current fiscal year compared with the prior fiscal year. The increase in cost of sales also resulted from the increase in the number of consultants on billing with clients. Cost of sales as a percentage

of revenue decreased from 83.8% in the fiscal year ended May 31, 2015 to 83.7% in the fiscal year ended May 31, 2016.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of expenses relating to account executives, technical recruiters, facilities costs, management and corporate overhead. These expenses increased \$237,000 or 2.7% from \$8,883,000 in the fiscal year ended May 31, 2015 to \$9,120,000 in the fiscal year ended May 31, 2016. This increase was primarily attributable to an increase in incentive compensation paid to account executives. Several of the account executives hired in recent years contributed increased revenues and earned incentive compensation in excess of their guaranteed incentive compensation for the first time. The Company expects selling, general and administrative expenses to continue to increase as more recruiters and sales executives are hired to stimulate growth. Selling, general and administrative expenses, as a percentage of revenue, decreased from 15.5% in the fiscal year ended May 31, 2015 to 14.9% in the fiscal year ended May 31, 2016 as a result of the additional revenue from the increase in the average daily rates charged for the consultants on billing with customers.

TSR INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Other Income

Other income for the fiscal year ended May 31, 2016 resulted primarily from interest and dividend income of \$9,000 decreased by a mark to market loss of approximately \$3,000 on the Company's marketable equity securities. Other income for the fiscal year ended May 31, 2015 resulted primarily from interest and dividend income of \$6,000 and a mark to market gain of approximately \$6,000 on the Company's marketable equity securities.

Income Taxes

The effective income tax rates were 46.0% for the fiscal year ended May 31, 2016 and 34.2% for the fiscal year ended May 31, 2015. The effective rate for the fiscal year ended May 31, 2016 increased primarily due to additional state taxes.

Net Income Attributable to TSR, Inc.

Net income attributable to TSR, Inc. increased \$206,000 from \$193,000 in the fiscal year ended May 31, 2015 to net income of \$399,000 in the fiscal year ended May 31, 2016. This increase in net income was primarily attributable to the increase in revenue as a result of the increase in the average daily rates charged for the consultants on billing with customers.

Liquidity, Capital Resources and Changes in Financial Condition

The Company expects that its available cash, certificates of deposit and marketable securities will be sufficient to provide the Company with adequate resources to meet its liquidity requirements for the next 12 months.

At May 31, 2016, the Company had working capital (total current assets in excess of total current liabilities) of \$9,391,000 including cash and cash equivalents and certificates of deposit and marketable securities of \$6,067,000 as compared to working capital of \$8,986,000 including cash and cash equivalents and certificates of deposit and marketable securities of \$4,941,000 at May 31, 2015.

Net cash flow of \$1,228,000 was provided by operations during fiscal 2016 as compared to \$714,000 of net cash flow provided by operations in fiscal 2015. The cash provided by operations for fiscal 2016 primarily resulted from consolidated net income of \$456,000 and a decrease in accounts receivable of \$1,036,000, offset, to some extent, by a decrease in accounts and other payables and accrued and other liabilities of \$155,000 and a decrease in advances from customers of \$186,000. The decrease in accounts receivable primarily resulted from a greater number of clients instituting prompt payment discounts. The cash provided by operations for fiscal 2015 primarily resulted from consolidated net income of \$292,000 and an increase in accounts payable and accrued expenses of \$362,000.

Net cash used in investing activities amounted to \$296,000 for fiscal 2016, compared to \$224,000 in net cash provided by investing activities in fiscal 2015. The net cash used in investing activities for fiscal 2016 primarily resulted from

investing in additional certificates of deposit. The cash provided in 2015 primarily resulted from maturing certificates of deposit, a portion of which were not rolled over.

Net cash used in financing activities of \$88,000 and \$109,000 during the fiscal years ended May 31, 2016 and 2015, respectively, resulted from distributions to the holder of the noncontrolling interest in the Company's subsidiary, Logixtech Solutions, LLC.

The Company's capital resource commitments at May 31, 2016 consisted of lease obligations on its branch and corporate facilities. The Company intends to finance these lease commitments from cash flow provided by operations, available cash and short-term marketable securities.

The Company's cash and marketable securities were sufficient to enable it to meet its liquidity requirements during fiscal 2016.

Impact of New Accounting Standards

In May 2014, the FASB issued an update to ASC 606, "Revenue from Contracts with Customers." This update to ASC 606 provides a five-step process to determine when and how revenue is recognized. The core principle of the guidance is that a company should recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration to be received in exchange for those goods or services. This update to ASC 606 will also result in enhanced disclosures about revenue, providing guidance for transactions that were not previously addressed comprehensively, and improving guidance for multiple-element arrangements. This update to ASC 606 is effective for the Company in the fiscal year ending May 31, 2018. The Company expects the impact of this update, if any, to be immaterial on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes," which applies to the classification of deferred tax assets and liabilities. The update eliminates the requirement to classify deferred tax assets and liabilities as noncurrent or current within a classified statement of financial position. This ASU is effective for annual and interim periods beginning after December 15, 2016 and should be applied prospectively with early adoption permitted at the beginning of an interim or annual reporting period. The Company is currently evaluating the impact of adopting this guidance.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in this update require all equity investments to be measured at fair value with changes in the fair value recognized through net income. The amendments in this update also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, the amendments in this update eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities and the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet for public business entities. This update is effective for the Company in the fiscal year ending May 31, 2019. The Company is currently evaluating the impact, if any, of this update on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." This update includes a lease accounting model that recognizes two types of leases – finance leases and operating leases. The standard requires that a lessee recognize on the balance sheet assets and liabilities relating to leases with terms of more than 12 months. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as a finance or operating lease. This update is effective for the Company in the fiscal year ending May 31, 2020. The Company is currently evaluating the impact, if any, of this update on its consolidated financial statements.

Critical Accounting Policies

The SEC defines "critical accounting policies" as those that require the application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The Company's significant accounting policies are described in Note 1 to its consolidated financial statements, contained elsewhere in this report. The Company believes that the following accounting policies require the application of management's most difficult, subjective or complex judgments:

Estimating Allowances for Doubtful Accounts Receivable

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current creditworthiness, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based on our historical experience, customer types, creditworthiness, economic trends and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. A significant change in the liquidity or financial position of any of our significant customers, or in their willingness to pay, could have a material adverse effect on the collectibility of our accounts receivable and our future operating results.

Valuation of Marketable Securities

The Company classifies its marketable securities at acquisition as either (i) held-to-maturity, (ii) trading or (iii) available-for-sale. Based upon the Company's intent and ability to hold its certificates of deposit to maturity (which maturities range up to 12 months), such securities have been classified as held-to-maturity and are carried at amortized cost, which approximates fair value. The Company's equity securities are classified as trading securities, which are carried at fair value, as determined by quoted market price, which is Level 1 input, as established by the fair value hierarchy. The related unrealized gains and losses are included in earnings.

Valuation of Deferred Tax Assets

We regularly evaluate our ability to recover the reported amount of our deferred income tax assets considering several factors, including our estimate of the likelihood of the Company generating sufficient taxable income in future years during the period over which temporary differences reverse. Presently, the Company believes that it is more likely than not that it will realize the benefits of its deferred tax assets based primarily on the Company's history of and projections for taxable income in the future. In the event that actual results differ from our estimates or we adjust these estimates in future periods, we may need to establish a valuation allowance against a portion or all of our deferred tax assets, which could materially impact our financial position or results of operations.

Forward-Looking Statements; Factors that Affect Future Results

Certain statements contained herein, including statements concerning the Company's plans, future prospects and future cash flow requirements are forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those set forth in the forward-looking statements due to known and unknown risks and uncertainties, including but not limited to, the following: the success of the Company's plan for internal growth, the impact of adverse economic conditions on the Company's business; risks relating to the competitive nature of the markets for contract computer programming services; the extent to which market conditions for the Company's contract computer programming services will continue to adversely affect the Company's business; the concentration of the Company's business with certain customers; uncertainty as to the Company's ability to maintain its relations with existing customers and expand its contract computer programming services business; the impact of changes in the industry, such as the use of vendor management companies in connection with the consultant procurement process; the increase in customers moving IT operations offshore; the Company's ability to adapt to changing market conditions; and other risks and uncertainties described in the Company's filings under the Securities Exchange Act of 1934. The Company is under no obligation to publicly update or revise forward-looking statements.

TSR INC. AND SUBSIDIARIES
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
TSR, Inc.
Hauppauge, New York

We have audited the accompanying consolidated balance sheets of TSR, Inc. and Subsidiaries as of May 31, 2016 and 2015, and the related consolidated statements of income, equity, and cash flows for the years then ended. TSR, Inc.'s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of TSR, Inc. and Subsidiaries as of May 31, 2016 and 2015 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



CohnReznick LLP
Jericho, New York
July 28, 2016

MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's shares of Common Stock trade on the NASDAQ Capital Market under the symbol TSRI. The following are the high and low sales prices for each quarter during the fiscal years ended May 31, 2016 and 2015:

June 1, 2015 – May 31, 2016

	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>
	<u>Quarter</u>	<u>Quarter</u>	<u>Quarter</u>	<u>Quarter</u>
High Sales Price	\$ 4.77	\$ 4.83	\$ 5.03	\$ 4.12
Low Sales Price	3.51	4.00	3.49	3.37

June 1, 2014 – May 31, 2015

	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>
	<u>Quarter</u>	<u>Quarter</u>	<u>Quarter</u>	<u>Quarter</u>
High Sales Price	\$ 3.88	\$ 3.59	\$ 4.84	\$ 5.50
Low Sales Price	2.90	3.05	3.34	3.66

There were 67 holders of record of the Company's Common Stock as of June 30, 2016. Additionally, the Company estimates that there were approximately 800 beneficial holders as of that date. There were no dividends declared or paid by the Company with respect to its shares of Common Stock during the last two fiscal years. The Company has no current plans to implement a quarterly dividend program or pay any other special cash dividend.

TSR
INC.

DIRECTORS

Joseph F. Hughes
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Chief Executive Officer
President and Treasurer

Christopher Hughes
Senior Vice President and
President TSR Consulting
Services, Inc.

James J. Hill
Director
Retired Executive Vice President
Sales & Marketing,
MRA Publications, Inc.

Brian J. Mangan
Director
Retired Senior Vice President
Finance,
ABC Television Network

Raymond A. Roel
Director
Principal,
Ray Roel Consulting LLC

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Chief Executive Officer
President and Treasurer

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John G. Sharkey
Vice President, Finance
and Secretary

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Copies of the Company's Form 10-K are available, without charge, to shareholders upon written request to:
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