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TSR INC  
Form 10-K  
August 08, 2007

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of The Securities  
Exchange Act of 1934

For the fiscal year ended May 31, 2007

or

Transition Report Under Section 13 or 15(d) of The Securities  
Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-8656

TSR, Inc.

-----  
(Exact name of registrant as specified in its charter)

Delaware

13-2635899

-----  
(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer Identification No.)

400 Oser Avenue, Hauppauge, NY 11788

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(Address of principal executive offices)

Registrant's telephone number: 631-231-0333

Securities registered pursuant to Section 12(b) of the Exchange Act:  
Common Stock, par value \$0.01 per share

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(Title of Class)

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

(Title of Class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as  
defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the Registrant is not required to file reports  
pursuant to Section 13 or Section 15(d) of the Exchange Act.  Yes  No

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

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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 if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-K contained in this form, and no disclosure will be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).  Large accelerated filer  Accelerated filer  Non-accelerated filer.

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

The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant based upon the closing price of \$4.00 at November 30, 2006 was \$11,102,000.

The number of shares of the Registrant's common stock outstanding as of July 31, 2007 was 4,568,012.

Documents incorporated by Reference:

The information required in Part III, Items 10, 11, 12, 13 and 14 is incorporated by reference to the Registrant's Proxy Statement in connection with the 2007 Annual Meeting of Stockholders, which will be filed by the Registrant within 120 days after the close of its fiscal year.

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PART I

## Edgar Filing: TSR INC - Form 10-K

### Item 1. Business.

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#### General

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TSR, Inc. (the "Company") is primarily engaged in the business of providing contract computer programming services to its clients. The Company provides its clients with technical computer personnel to supplement their in-house information technology ("IT") capabilities. The Company's clients for its contract computer programming services consist primarily of Fortune 1000 companies with significant technology budgets. In the year ended May 31, 2007, the Company provided IT staffing services to approximately 90 clients.

The Company was incorporated in Delaware in 1969. The Company's executive offices are located at 400 Oser Avenue, Hauppauge, NY 11788, and its telephone number is (631) 231-0333. This annual report, and each of our other periodic and current reports, including any amendments, are available, free of charge, on our website, [www.tsrconsulting.com](http://www.tsrconsulting.com), as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission. The information contained on our website is not incorporated by reference into this annual report on Form 10-K and should not be considered part of this report.

#### Contract Computer Programming Services

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##### STAFFING SERVICES

The Company's contract computer programming services involve the provision of technical staff to clients to meet the specialized requirements of their IT operations. The technical personnel provided by the Company generally supplement the in-house capabilities of the Company's clients. The Company's approach is to make available to its clients a broad range of technical personnel to meet their requirements rather than focusing on specific specialized areas. The Company has staffing capabilities in the areas of mainframe and mid-range computer operations, personal computers and client-server support, internet and e-commerce operations, voice and data communications (including local and wide area networks) and help desk support. The Company's services provide clients with flexibility in staffing their day-to-day operations, as well as special projects, on a short-term or long-term basis.

The Company provides technical employees for projects, which usually range from three months to one year. Generally, clients may terminate projects at any time. Staffing services are provided at the client's facility and are billed primarily on an hourly basis based on the actual hours worked by technical personnel provided by the Company and with reimbursement for out-of-pocket expenses. The Company pays its technical personnel on a semi-monthly basis and invoices its clients, not less frequently than monthly.

The Company's success is dependent upon, among other things, its ability to attract and retain qualified professional computer personnel. The Company believes that there is significant competition for software professionals with the skills and experience necessary to perform the services offered by the Company. Although the Company generally has been successful in attracting employees with the skills needed to fulfill customer engagements, demand for qualified professionals conversant with certain technologies may outstrip supply as new and additional skills are required to keep pace with evolving computer technology or as competition for technical personnel increase. Increasing demand for qualified personnel could also result in increased expenses to hire and retain qualified technical personnel and could adversely affect the Company's profit margins.

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In the past few years, an increasing number of companies are using or are considering using low cost offshore outsourcing centers, particularly in India, to perform technology related work and projects. This trend has contributed to the decline in domestic IT staffing revenues. There can be no assurance that this trend will not continue to adversely impact the Company's IT staffing revenues.

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### OPERATIONS

The Company provides contract computer programming services in the New York metropolitan area, New England, and the Mid-Atlantic region. The Company provides its services principally through offices located in New York, New York, Edison, New Jersey and Long Island, New York. The Company does not currently intend to open additional offices. The Company is in the process of hiring additional account executives and technical recruiters in its existing offices to address increased competition and to promote revenue growth. The hiring process has been taking longer than expected due a combination of limited qualified candidates and increased compensation expectations of qualified candidates. As of May 31, 2007, the Company employed 14 persons who are responsible for recruiting technical personnel and 14 persons who are account executives. As of May 31, 2006 the Company had employed 14 technical personnel recruiters and 10 account executives.

The Company intends to increase the number of technical recruiters it employs to address increased competition, especially at accounts with vendor management. During fiscal year 2006, to supplement its in-house recruiters, the Company contracted with an India based company to provide recruiting and recruiting support in locating technical consultants in the United States. During fiscal 2007 the number of recruiters provided by this India based company increased from 2 to 4.

### MARKETING AND CLIENTS

The Company focuses its marketing efforts on large businesses and institutions with significant IT budgets and recurring staffing and software development needs. The Company provided services to approximately 90 clients during the year ended May 31, 2007 as compared to 80 in the prior fiscal year. The Company has historically derived a significant percentage of its total revenues from a relatively small number of clients. In the fiscal year ended May 31, 2007, the Company had two clients which constituted more than 10% of consolidated revenues (Procurestaff Ltd., 19.1% and Ensemble-Chimes, 11.3%). Procurestaff Ltd. and Ensemble-Chimes are vendor management services providers. In excess of 90% of the revenue generated from Procurestaff Ltd. was from AT&T as the end client. In excess of 90% of the revenue generated from Ensemble-Chimes was derived from two clients, neither of which individually constituted more than 10% of revenues. Additionally, the Company's top ten clients accounted for 71% of consolidated revenues in fiscal 2007 and 70% in fiscal 2006. While continuing its efforts to expand further its client base, the Company's marketing efforts are focused primarily on increasing business from its existing accounts.

The Company's marketing is conducted through account executives that are responsible for customers in an assigned territory. Account executives call on potential new customers and are also responsible for maintaining existing client contacts within an assigned territory. Instead of utilizing technical managers to oversee the services provided by technical personnel to each client, the account executives are responsible for this role. As a result of the cost savings due to the combined functions of the account executives, the Company is able to provide its account executives with significantly higher incentive-based compensation. In addition, the Company generally pairs each account executive with a recruiter of technical personnel, who also receives incentive-based compensation. The Company believes that this approach allows the Company to more

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effectively serve its clients' needs for technical personnel, as well as providing its account executives and recruiters with incentives to maximize revenues in their territories.

The Company's marketing has been affected because some major customers have retained a third party to provide vendor management services and centralize the consultant hiring process. Under this system, the third party retains the Company to provide contract computer programming services and the Company bills the third party and the third party bills the ultimate customer. This process weakens the relationship the Company has built with its client contacts, the project managers, who the Company would normally work directly with to place consultants. Instead, the Company is required to interface with the vendor management provider, making it more difficult to maintain its relationships with its customers and preserve and expand its business. These changes have also reduced the Company's profit margins because the vendor management company is retained for the purpose of keeping costs down for the end client and receives a processing fee which is deducted from the payment to the Company.

In accordance with industry practice, most of the Company's contracts for contract computer programming services are terminable by either the client or the Company on short notice. The Company does not believe that backlog is material to its business.

In June 2006, the New York State Office of General Services, Procurement Services Group ("OGS") terminated its contract with the Company. The OGS actions were due to the report of an investigation by the Office of the Special Commissioner of Investigation of the New York City Department of Education ("DOE"). The investigative report concluded that the Company operated improperly from 2001 through the spring of 2003 by using a subcontracting arrangement to obtain programmers for positions with the DOE.

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The DOE also asserted a claim against the Company for a reimbursement due to the Company's subcontracting without written authorization. While the Company believes that its subcontracting did not result in overcharges to DOE, it has settled the matter in order to avoid the expense and uncertainty of litigation. The reserve of \$900,000 relating to this claim which was established at May 31, 2006 was sufficient to cover the settlement which was finalized in May 2007. The last of the remaining consultants placed with the DOE were terminated in April 2007 and the Company will not be making any new placements with DOE. The DOE accounted for approximately 13% of the Company's revenues during its fiscal year ended May 31, 2006 and 4% during fiscal 2007.

### PROFESSIONAL STAFF AND RECRUITMENT

In addition to using internet based job boards such as Dice, Net Temps and Monster, the Company maintains a database of over 100,000 technical personnel with a wide range of skills. The Company uses a sophisticated proprietary computer system to match a potential employee's skills and experience with client requirements. The Company periodically contacts personnel in its database to update their availability, skills, employment interests and other matters and continually updates its database. This database is made available to the account executives and recruiters at each of the Company's offices. The Company considers its database to be a valuable asset.

The Company employs technical personnel primarily on an hourly basis, as required in order to meet the staffing requirements under particular contracts or for particular projects. The Company recruits technical personnel by posting jobs on the on the Internet, publishing advertisements in local newspapers and attending job fairs on a periodic basis. The Company devotes significant resources to recruiting technical personnel, maintaining 14 recruiters based in

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the U.S. and contracting with an India based company for 4 recruiters in India to help locate U.S. based technical consultants. Potential applicants are generally interviewed and tested by the Company's recruiting personnel, by third parties that have the required technical backgrounds to review the qualifications of the applicants, or by on-line testing services. In some cases, instead of employing technical personnel directly, the Company uses subcontractors who employ the technical personnel who are provided to the Company's customers.

### Competition

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The technical staffing industry is highly competitive and fragmented and has low barriers to entry. The Company competes for potential clients with providers of outsourcing services, systems integrators, computer systems consultants, other providers of technical staffing services and, to a lesser extent, temporary personnel agencies. Many of the Company's competitors are significantly larger and have greater financial resources than the Company. The Company believes that the principal competitive factors in obtaining and retaining clients are accurate assessment of clients' requirements, timely assignment of technical employees with appropriate skills and the price of services. The principal competitive factors in attracting qualified technical personnel are compensation, availability, quality and variety of projects and schedule flexibility. The Company believes that many of the technical personnel included in its database may also be pursuing other employment opportunities. Therefore, the Company believes that its responsiveness to the needs of technical personnel is an important factor in the Company's ability to fill projects. Although the Company believes it competes favorably with respect to these factors, it expects competition to increase and there can be no assurance that the Company will remain competitive.

### Intellectual Property Rights

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The Company relies primarily upon a combination of trade secret, nondisclosure and other contractual arrangements to protect its proprietary rights. The Company generally enters into confidentiality agreements with its employees, consultants, clients and potential clients and limits access to and distribution of its proprietary information. There can be no assurance that the steps taken by the Company in this regard will be adequate to deter misappropriation of its proprietary information or that the Company will be able to detect unauthorized use and take appropriate steps to enforce its intellectual property rights.

### Personnel

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As of May 31, 2007, the Company employs 216 people including its 2 executive officers. Of such employees 14 are engaged in sales, 14 are recruiters for programmers, 174 are technical and programming consultants, and 12 are in administration and clerical functions. None of the Company's employees belong to unions.

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### Item 1A. Risk Factors.

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Certain statements contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business", including statements concerning the Company's future prospects and the Company's future cash flow requirements are forward looking statements, as defined in the Private

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Securities Litigation Reform Act of 1995. Actual results may differ materially from those projections in the forward looking statements which statements involve risks and uncertainties, including but not limited to the factors set forth below.

### Dependence Upon Key Personnel.

The Company is dependent on its Chairman of the Board, Chief Executive Officer and President, Joseph Hughes. The Company does not currently have an employment agreement with Mr. Hughes. The Company is also dependent on certain of its account executives who are responsible for servicing its principal customers and attracting new customers. The Company does not have employment contracts with these persons. There can be no assurance that the Company will be able to retain its existing personnel or find and attract additional qualified employees. The loss of the services of any of these personnel could have a material adverse effect on the Company.

### Dependence on Significant Customers.

In the fiscal year, ended May 31, 2007, the Company's largest clients, Procurestaff Ltd. and Ensemble-Chimes accounted for 19.1% and 11.3% of the Company's consolidated revenues, respectively. Procurestaff and Ensemble-Chimes are vendor management companies. In excess of 90% of the revenues received from Procurestaff relate to a single customer, AT&T, while in excess of 90% of the revenues received from Ensemble-Chimes were derived from two customers which individually did not exceed 10% of revenues. The New York City Department of Education (DOE) accounted for 13.0% of the Company's consolidated revenues in fiscal 2006 and 4.3% in fiscal 2007. The last remaining consultants on billing with the DOE were terminated in April 2007. Client contract terms vary depending on the nature of the engagement, and there can be no assurance that a client will renew a contract when it terminates. In addition, the Company's contracts are generally cancelable by the client at any time on short notice, and clients may unilaterally reduce their use of the Company's services under such contracts without penalty. See "Rapidly Changing Industry" below.

### Competitive Market for Technical Personnel.

The Company's success is dependent upon its ability to attract and retain qualified computer professionals to provide as temporary personnel to its clients. Competition for the limited number of qualified professionals with a working knowledge of certain sophisticated computer languages, which the Company requires for its contract computer services business, is intense. The Company believes that there is a shortage of, and significant competition for, software professionals with the skills and experience necessary to perform the services offered by the Company.

The Company's ability to maintain and renew existing engagements and obtain new business in its contract computer programming business depends, in large part, on its ability to hire and retain technical personnel with the IT skills that keep pace with continuing changes in software evolution, industry standards and technologies, and client preferences. Although the Company generally has been successful in attracting employees with the skills needed to fulfill customer engagements, demand for qualified professionals conversant with certain technologies may outstrip supply as new and additional skills are required to keep pace with evolving computer technology or as competition for technical personnel increases. Increasing demand for qualified personnel could also result in increased expenses to hire and retain qualified technical personnel and could adversely affect the Company's profit margins.

### Competitive Market for Account Executives and Technical Recruiters

The Company has been seeking to hire qualified account executives and technical

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recruiters to meet competition and promote growth. The Company faces a highly competitive market for the limited number of qualified personnel and there can be no assurance that the Company will be successful in hiring such personnel.

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### Rapidly Changing Industry

The computer industry is characterized by rapidly changing technology and evolving industry standards. These include the overall increase in the sophistication and interdependency of computer technology and a focus by IT managers on cost-efficient solutions. Recently, there has been an increased focus on the Internet and e-Commerce and there has been a shift away from mainframe legacy systems. Historically, much of the Company's staffing services has related to mainframe legacy systems. There can be no assurance that these changes will not adversely affect demand for technical staffing services. Organizations may elect to perform such services in-house or outsource such functions to companies that do not utilize temporary staffing, such as that provided by the Company.

There have also been recent changes in the industry, which could potentially affect the Company's operating results. Many customers have begun retaining third parties to provide vendor management services. The third party is then responsible for retaining companies to provide temporary IT personnel. This results in the Company contracting with such third parties and not directly with the ultimate customer. This change weakens the Company's relationship with its customer, which makes it more difficult for the Company to maintain and expand its business. It also reduces the Company's profit margins.

Additionally, a number of companies have begun limiting the number of companies on their approved vendor lists, and in some cases this has required the Company to sub-contract with a company on the approved vendor list to provide services to customers. The staffing industry has also experienced margin erosion caused by this increased competition, and customers leveraging their buying power by consolidating the number of vendors with which they deal.

In addition to these factors, there has been intense price competition in the area of IT staffing, pressure on billing rates and pressure by customers for discounts.

The Company cannot predict at this time what long-term effect these changes will have on the Company's business and results of operations.

### Effect of Fluctuations in Economic Conditions

Demand for the Company's IT staffing services is significantly affected by the general economic environment. During periods of slowing economic activity, customers may reduce their IT projects and their demand for outside consultants. As a result, any significant economic downturn could have material adverse affect on the Company's results of operations. The Company attributes a significant portion of its decline in revenues to customers reducing their spending on IT projects as a result of the economic environment.

The current trend of companies moving technology jobs and projects offshore has caused and could continue to cause revenues to decline. In the past few years, more companies are using or are considering using low cost offshore outsourcing centers, particularly in India, to perform technology related work and projects. This trend has contributed to the decline in domestic IT staffing revenue. There can be no assurance that this trend will not continue to adversely impact the Company's IT staffing revenues.



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### Fluctuations in Quarterly Operating Results.

The Company's revenues and operating results are subject to significant variations from quarter to quarter. Revenues are subject to fluctuation based upon a number of factors, including the timing and number of client projects commenced and completed during the quarter, delays incurred in connection with projects, the growth rate of the market for contract computer programming services and general economic conditions. Unanticipated termination of a project or the decision by a client not to proceed to the next stage of a project anticipated by the Company could result in decreased revenues and lower utilization rates which could have a material adverse effect on the Company's business, operating results and financial condition. Compensation levels can be impacted by a variety of factors, including competition for highly skilled employees and inflation. The Company's operating results are also subject to fluctuation as a result of other factors.

### Intellectual Property Rights.

The Company relies primarily upon a combination of trade secret, nondisclosure and other contractual agreements to protect its proprietary rights. The Company generally enters into confidentiality agreements with its employees, consultants, clients and potential clients and limits access to and distribution of its proprietary information. There can be no assurance that the steps taken by the Company in this regard will be adequate to deter misappropriation of its proprietary information or that the Company will be able to detect unauthorized use and take appropriate steps to enforce its intellectual property rights.

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### Competition.

The technical staffing industry is highly competitive and fragmented and has low barriers to entry. The Company competes for potential clients with providers of outsourcing services, systems integrators, computer systems consultants, other providers of technical staffing services and, to a lesser extent, temporary personnel agencies. The Company competes for technical personnel with other providers of technical staffing services, systems integrators, providers of outsourcing services, computer systems consultants, clients and temporary personnel agencies. Many of the Company's competitors are significantly larger and have greater financial resources than the Company. The Company believes that the principal competitive factors in obtaining and retaining clients are accurate assessment of clients' requirements, timely assignment of technical employees with appropriate skills and the price of services. The principal competitive factors in attracting qualified technical personnel are compensation, availability, quality and variety of projects and schedule flexibility. The Company believes that many of the technical personnel included in its database may also be pursuing other employment opportunities. Therefore, the Company believes that its responsiveness to the needs of technical personnel is an important factor in the Company's ability to fill projects. Although the Company believes it competes favorably with respect to these factors, it expects competition to increase, and there can be no assurance that the Company will remain competitive.

### Potential for Contract and Other Liability.

The personnel provided by the Company to clients provide services involving key aspects of its clients' software applications. A failure in providing these services could result in a claim for substantial damages against the Company, regardless of the Company's responsibility for such failure. The Company attempts to limit, contractually, its liability for damages arising from negligence or omissions in rendering services, but it is not always successful

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in negotiating such limits. Despite this precaution, there can be no assurance that the limitations of liability set forth in its contracts would be enforceable or would otherwise protect the Company from liability for damages.

The Company's contract computer programming services business involves assigning technical personnel to the workplace of the client, typically under the client's supervision. Although the Company has little control over the client's workplace, the Company may be exposed to claims of discrimination and harassment and other similar claims as a result of inappropriate actions allegedly taken against technical personnel by clients. As an employer, the Company is also exposed to other possible employment-related claims. The Company is exposed to liability with respect to actions taken by its technical personnel while on a project, such as damages caused by technical personnel, errors, and misuse of client proprietary information or theft of client property. To reduce such exposures, the Company maintains insurance policies and a fidelity bond covering general liability, worker's compensation claims, errors and omissions and employee theft. In certain instances, the Company indemnifies its clients from the foregoing and claims have been made against the Company. Certain of these cost and liabilities are not covered by insurance. There can be no assurance that insurance coverage will continue to be available and at its current price or that it will be adequate to, or will, cover any such liability.

### Voting Power of Major Shareholder

Joseph F. Hughes and members of his family own Common Stock, representing approximately 39% of the Company's voting power as of July 31, 2007. As such, Joseph Hughes has significant voting power on all matters submitted to a vote of the Company's common shareholders.

### Certain Anti-Takeover Provisions May Inhibit a Change of Control

In addition to the significant ownership of Common Stock by Joseph F. Hughes, certain provisions of the Company's charter and by-laws may have the effect of discouraging a third party from making an acquisition proposal for the Company and may thereby inhibit a change in control of the Company under circumstances that could give the holders of Common Stock the opportunity to realize a premium over the then-prevailing market prices. Such provisions include a classified Board of Directors, advance notice requirements for nomination of directors and certain shareholder proposals set forth in the Company's Certificate of Incorporation and by-laws.

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### New Classes and Series of Stock

The Company's charter authorizes the Board of Directors to create new classes and series of preferred stock and to establish the preferences and rights of any such classes and series without further action of the shareholders. The issuance of additional classes or series of Capital Stock may have the effect of delaying, deferring or preventing a change in control of the Company.

The Company's Stock Price Could Be Extremely Volatile And, As A Result, Investors May Not Be Able To Resell Their Shares At Or Above The Price They Paid For Them.

Among the factors that could affect the Company's stock price are:

- limited float and a low average daily trading volume;
- industry trends and the performance of the Company's customers;

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- fluctuations in the Company's results of operations;
- litigation; and
- general market conditions.

The stock market has and may in the future experience extreme volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the market price of the Company's common stock.

Item 1B. Unresolved Staff Comments - None  
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Item 2. Properties.  
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The Company leases 8,000 square feet of space in Hauppauge, New York for a term expiring November 30, 2010, with annual rentals of approximately \$70,000. This space is used as executive and administrative offices for the Company and the Company's operating subsidiary. The Company also leases sales and technical recruiting offices in New York City (lease expires July, 2012) and Edison, New Jersey (lease expires August, 2008), with aggregate monthly rentals of approximately \$23,000.

The Company believes the present locations are adequate for its current needs as well as for the future expansion of its existing business.

Item 3. Legal Proceedings.  
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There are no material legal proceedings.

Item 4. Submission of Matters to a Vote of Security Holders.  
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Not Applicable

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## PART II

Item 5. Market for Common Equity and Related Stockholder Matters.  
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The Company's shares of Common Stock trade on the NASDAQ Global Market under the symbol TSRI. The following are the high and low sales prices for each quarter during the fiscal years ended May 31, 2007 and 2006:

|                       | JUNE 1, 2006 - MAY 31, 2007 |         |         |         |
|-----------------------|-----------------------------|---------|---------|---------|
|                       | 1ST                         | 2ND     | 3RD     | 4TH     |
|                       | QUARTER                     | QUARTER | QUARTER | QUARTER |
|                       | -----                       | -----   | -----   | -----   |
| High Sales Price..... | 5.50                        | 4.75    | 4.79    | 4.53    |
| Low Sales Price.....  | 3.55                        | 3.80    | 3.85    | 3.80    |

|  | JUNE 1, 2005 - MAY 31, 2006 |         |         |         |
|--|-----------------------------|---------|---------|---------|
|  | 1ST                         | 2ND     | 3RD     | 4TH     |
|  | QUARTER                     | QUARTER | QUARTER | QUARTER |

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|                       | ----- | ----- | ----- | ----- |
|-----------------------|-------|-------|-------|-------|
| High Sales Price..... | 6.38  | 6.00  | 11.16 | 6.04  |
| Low Sales Price.....  | 5.10  | 4.35  | 4.50  | 4.30  |

There were 133 holders of record of the Company's Common Stock as of July 31, 2007. Additionally, the Company estimates that there were approximately 1,500 beneficial holders as of that date. On June 23, 2003, the Company declared a special, large nonrecurring dividend of \$2.00 per share payable on July 28, 2003 to holders of record as of July 11, 2003. Additionally, the Company declared quarterly dividends of \$0.15 during the fiscal years ended May 31, 2004 and 2005. The dividend was \$0.08 per quarter for fiscal 2006 and 2007. The Company has not determined its dividend policy for fiscal 2008. There can be no assurance that the Company will continue to pay dividends.

Securities authorized for issuance under equity compensation plans.

The 1997 Employee Stock Option Plan, the Company's lone equity compensation plan, expired on April 30, 2007.

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Item 6. Selected Financial Data.

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(Amounts in Thousands, Except Per Share Data)

|   | MAY 31,<br>2007<br>---- | May 31,<br>2006<br>---- | May 31,<br>2005<br>---- | May<br>20<br>-- |
|---|-------------------------|-------------------------|-------------------------|-----------------|
| Revenues .....                                      | \$49,689                | \$48,109                | \$51,444                | \$51,           |
| Income From Operations .....                        | 1,925                   | 1,709                   | 3,635                   | 3,              |
| Net Income .....                                    | 1,393                   | 1,214                   | 2,145                   | 2,              |
| Basic and Diluted Net Income Per Common Share ..... | 0.30                    | 0.27                    | 0.47                    | 0               |
| Working Capital .....                               | 12,815                  | 12,368                  | 14,391                  | 14,             |
| Total Assets .....                                  | 18,059                  | 18,635                  | 18,531                  | 19,             |
| Stockholders' Equity .....                          | 13,952                  | 14,021                  | 14,589                  | 15,             |
| Book Value Per Common Share .....                   | 3.05                    | 3.07                    | 3.19                    | 3               |
| Cash Dividends Declared Per Common Share .....      | \$ 0.32                 | \$ 0.32                 | \$ 0.60                 | \$ 2            |

Unaudited Quarterly Financial Data  
(Amounts in Thousands, except Per Share Data)

The following is a summary of unaudited quarterly operating results for the fiscal years ended May 31, 2007 and 2006.

|  | Fiscal 2007<br>----- |                 |                |                 |
|--|----------------------|-----------------|----------------|-----------------|
|  | First<br>-----       | Second<br>----- | Third<br>----- | Fourth<br>----- |

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|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Revenues .....   | \$12,376 | \$12,626 | \$11,774 | \$12,913 |
| Gross Profit .....                                     | 2,377    | 2,369    | 2,052    | 2,357    |
| Net Income .....                                       | 444      | 413      | 201      | 335      |
| Basic and Diluted Net Income<br>per Common Share ..... | \$ 0.10  | \$ 0.09  | \$ 0.04  | \$ 0.07  |

Fiscal 2006

|   | First<br>-----<br>First | Second<br>----- | Third<br>----- | Fourth<br>----- |
|---|-------------------------|-----------------|----------------|-----------------|
| Revenues .....  | \$12,465                | \$11,829        | \$11,595       | \$12,220        |
| Gross Profit .....  | 2,526                   | 2,369           | 2,108          | 2,346           |
| Net Income (Loss) .....                                       | 474                     | 484             | 289            | (33)            |
| Basic and Diluted Net Income<br>(Loss) per Common Share ..... | \$ 0.10                 | \$ 0.11         | \$ 0.06        | \$ (0.01)       |

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Item 7. Management's Discussion and Analysis of Financial Condition and Results  
-----  
of Operations.  
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The following discussion and analysis should be read in conjunction with the Company's consolidated financial statements and the 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 earnings. There can be no assurance that historical trends in operating results will continue in the future:

|   | YEAR ENDED MAY 31             |         |          |       |
|---|-------------------------------|---------|----------|-------|
|   | (DOLLAR AMOUNTS IN THOUSANDS) |         |          |       |
|   | 2007                          |         | 2006     |       |
|   | -----                         |         | -----    |       |
|   | AMOUNT                        | % OF    | Amount   | % of  |
|   | -----                         | REVENUE | -----    | Reven |
|   |                               | -----   |          | ----- |
| Revenues .....                                      | \$49,689                      | 100.0   | \$48,109 | 100.0 |
| Cost of Sales .....                                 | 40,534                        | 81.6    | 38,760   | 80.0  |
| Gross Profit .....                                  | 9,155                         | 18.4    | 9,349    | 19.0  |
| Selling, General, and Administrative Expenses ..... | 7,230                         | 14.5    | 7,640    | 15.0  |
| Income from Operations .....                        | 1,925                         | 3.9     | 1,709    | 3.0   |
| Other Income .....                                  | 409                           | 0.8     | 279      | 0.0   |

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|                                  |          |       |          |       |
|----------------------------------|----------|-------|----------|-------|
|                                  | -----    | ----- | -----    | ----- |
| Income Before Income Taxes ..... | 2,334    | 4.7   | 1,988    | 4.    |
| Provision for Income Taxes ..... | 941      | 1.9   | 774      | 1.    |
| Net Income .....                 | \$ 1,393 | 2.8   | \$ 1,214 | 2.    |
|                                  | =====    | ===== | =====    | ===== |

### Revenues

Revenues consist primarily of revenues from computer programming consulting services. Revenues for the fiscal year ended May 31, 2007 increased \$1,580,000 or 3.3% from fiscal 2006. Although revenues from the New York City Department of Education (DOE) decreased by approximately \$4,100,000, increases from other customers, notably Procurestaff and Ensemble-Chimes, caused overall revenues to increase. The average number of consultants on billing with customers decreased from approximately 343 for the fiscal year ended May 31, 2006 to 335 for the fiscal year ended May 31, 2007. Changes in the business mix toward higher level skills allowed the Company to increase its average billing rates to customers, offsetting the slight decrease in the average number of consultants on billing with customers.

More than 90% of the revenues received from Procurestaff related to AT&T. As a result of the merger of AT&T with SBC Communications, Inc., Procurestaff, which had been the sole vendor management company for AT&T is currently one of many vendors to the new AT&T and no longer serves as the primary vendor manager. Due to these changes, the Company experienced a decrease in new placements with AT&T beginning in the second quarter of fiscal 2007. This has reduced the number of consultants on billing with AT&T from 100 at August 31, 2006 to 72 at May 31, 2007. The Company is unable to predict whether this change in relationship will continue to impact the Company's business relationship with AT&T.

The Company's contract to provide services to the DOE was terminated in June 2006 (See "Marketing and Clients"). The DOE accounted for 13.0% of the Company's consolidated revenues in fiscal 2006, while accounting for 4.3% of revenues in fiscal 2007. There were 41 consultants on billing with the DOE at May 31, 2006. The last remaining consultants were terminated in April 2007.

The Company's revenues from programmers on billing continue to be affected by discounts, such as prompt payment and volume discounts, required by major customers as a condition to remaining on their approved vendor lists and the reduction in the number of vendors on the approval vendor lists to increase pricing competition among the remaining vendors. In addition, some major customers have retained third parties to provide vendor management services and centralize the consultant hiring process. Under this system, the third party retains the Company to provide contract computer programming services and the Company bills the third party and the third party bills the ultimate customer. This process weakens the relationship the Company has built with its client contacts, the project managers, who the Company would normally work directly with to place consultants. Instead, the Company is required to interface with the

vendor management provider, making it more difficult to maintain its relationships with its customers and preserve and expand its business. These changes have also reduced the Company's profit margins because the vendor management company is retained for the purpose of keeping costs down for the end client and receives a processing fee which is deducted from the payment to the

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Company. Revenues have also been impacted by the increased use of offshore development companies, particularly in India, over the past few years to provide technology related work and projects. The Company is unable to predict the long-term effects of these changes.

Although there has been some improvement in market conditions during the past few years, revenues have not improved significantly since the Company has not yet fully adapted its business model to more effectively deal with changing market factors such as vendor management and off-shore IT operations. A focus of the Company's plan has been to hire additional experienced account executives and technical recruiters to address increased competition and to promote revenue growth. This process has taken longer than expected due to a combination of limited qualified candidates and increased compensation expectations of qualified candidates.

Revenues for fiscal 2006 decreased \$3,336,000 or 6.5% from fiscal 2005, substantially all of which related to a decrease with the Company's largest customer, Procurestaff, Ltd. (end client AT&T). Of this decrease, approximately \$1.9 million was attributable to a decrease in the number of consultants on billing with this customer and approximately \$1.4 million was attributable to the previously disclosed price reduction mandated by this customer. Beginning in May 2005, Procurestaff, Ltd. instituted a change in its pricing methodology for AT&T which not only reduced the Company's revenues but significantly decreased gross profit derived from this account because the Company was not able to reduce amounts paid to its consultants.

### Cost of Sales

-----

Cost of sales increased by \$1,774,000, in fiscal 2007 from fiscal 2006. Cost of sales as a percentage of revenues increased to 81.6% in fiscal 2007 from 80.6% in fiscal 2006. The increase in cost of sales resulted primarily from increased revenues. The increase in cost of sales as a percentage of revenues is due to additional mandatory discount programs, as discussed above under Revenues.

Fiscal 2006 cost of sales decreased \$1,540,000, compared to fiscal 2005. Cost of sales as a percentage of revenues increased to 80.6% in fiscal 2006 from 78.3% in fiscal 2005. The overall decrease in the cost of sales resulted from a decrease in the number of programmers on billing with customers. The increase in cost of sales as a percentage of revenues was due to lower pricing, particularly at the Company's largest customer Procurestaff Ltd. (end client AT&T) which accounted for approximately one half of the percentage increase and additional mandatory discount programs at other large customers.

### 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 decreased \$410,000, or 5.4%, from \$7,640,000 in fiscal 2006 to \$7,230,000 in fiscal 2007. The decrease was primarily the result of a \$900,000 reserve established in fiscal 2006 to settle claims by the DOE against the Company for subcontracting without authorization. Without the reserve, these expenses would have increased by \$490,000 primarily due to increased selling expenses of \$302,000 and increased recruiting expenses of \$211,000. This increase resulted primarily from increases in the number of account executives and technical recruiters as well as increased compensation for the recruiters. Selling, general and administrative expenses are expected to increase going forward as the Company has plans to continue hiring additional account executives and technical recruiters to address increasing competition, especially at accounts with third party vendor management organizations in place.

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Selling, general and administrative expenses increased \$130,000 or 1.7% from \$7,510,000 in fiscal 2005 to \$7,640,000 in fiscal 2006. This increase was primarily the result of the \$900,000 reserve established to settle claims by the DOE against the Company for subcontracting without written authorization. Without this reserve, these expenses would have decreased by almost \$770,000 primarily due to decreased selling expenses of \$450,000 and a decrease in expenses of \$180,000 due to the termination of the effort to establish a new service offering.

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### Other Income

-----

Fiscal 2007 other income resulted primarily from interest and dividend income of \$461,000, which increased from the level realized in 2006 due to higher interest rates. The Company also had an unrealized gain of \$3,000 from marketable securities due to market adjustments of its equity portfolio.

Fiscal 2006 other income resulted primarily from interest and dividend income of \$358,000, which increased from the level realized in 2005 due to higher interest rates. The Company also had an unrealized loss of \$7,000 from marketable securities due to market adjustments of its equity portfolio.

### Income Taxes

-----

The effective income tax rate increased to 40.3% in fiscal 2007 from 38.9% in fiscal 2006 because fiscal 2006 benefited from the reversal of prior years' income tax over accruals. The over accruals resulted primarily from providing for state income taxes in excess of what was actually due with the filed returns.

The effective income tax rate decreased to 38.9% in fiscal 2006 from 42.7% in fiscal 2005 because of lower state and local taxes and reversal of prior years' income tax over accruals.

### Net Income

-----

Net income increased \$179,000 or 14.7% in fiscal 2007 from fiscal 2006. Net income increased primarily due to the pre-tax reserve of \$900,000 established in fiscal 2006 to settle claims made by the DOE. Without the reserve, net income would have decreased \$291,000 or 17.3% from fiscal 2006. This decrease was primarily due to increased selling and recruiting expenses. Also, gross profit decreased while revenues increased because additional discount programs at major customers further decreased margins.

Net income decreased \$931,000 or 43.4% in fiscal 2006 from fiscal 2005. Net income decreased primarily due to the pre-tax reserve of \$900,000 established to settle claims made by DOE. Without the reserve for DOE claims, net income would have decreased \$461,000 or 21.5% from fiscal 2005 and income from operations would have been reduced \$1,026,000 or 28.2% from fiscal 2005. Net income also decreased at a higher rate than revenues decreased due to the price reduction instituted by the Company's largest customer and additional mandatory discount programs at other large customers. These price reductions did not allow for any offsetting cost reductions in the amounts paid to the consultants on billing with the customers. These price reductions, along with a decrease in the number of consultants on billing with customers and the DOE reserve, were primarily responsible for the reduction in the Company's income from operations of



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\$1,926,000 or 53.0% from fiscal 2005. The reduced effective income tax rate due to the reversal of prior years' over accruals offset, to some extent, the impact that the special reserve, price reductions and decreased number of consultants had on net income.

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### Liquidity, Capital Resources and Changes in Financial Condition

---

The Company expects that cash flow generated from operations together with its available cash and marketable securities and available credit facilities will be sufficient to provide the Company with adequate resources to meet its liquidity requirements for the foreseeable future.

At May 31, 2007, the Company had working capital of \$12,815,000 including cash and cash equivalents of \$1,900,000 as compared to working capital of \$12,368,000 including cash and cash equivalents of \$2,661,000 at May 31, 2006. The Company's working capital also included \$6,395,000 and \$5,407,000 of marketable securities with maturities of less than one year at May 31, 2007 and 2006, respectively. The majority of increase in working capital occurred due to the reduction of marketable securities with maturities in excess of one year.

Net cash flow of \$1,298,000 was provided by operations during fiscal 2007 as compared to \$965,000 of net cash flow from operations in fiscal 2006. The cash flow from operations for fiscal 2007 primarily resulted from net income of \$1,393,000 and a decrease in accounts payable and accrued expenses of \$442,000. The cash flow from operations for fiscal 2006 primarily resulted from net income of \$1,214,000 and an increase in accounts payable and accrued expenses of \$708,000 offset by an increase in accounts receivable of \$689,000 and an increase in prepaid and receivable income taxes of \$305,000.

Net cash used in investing activities amounted to \$527,000 for fiscal 2007, compared to \$980,000 in net cash provided by investing activities in fiscal 2006. The net cash flows used in investing activities in fiscal 2007 primarily resulted from the purchase of marketable securities. The net cash flows provided by investing activities in fiscal 2006 primarily resulted from the maturing of marketable securities.

Cash used in financing activities during the fiscal year ended May 31, 2007 resulted from cash dividends paid of \$1,462,000 and a distribution of \$70,000 to the minority interest. Cash used in financing activities during the fiscal year ended May 31, 2006 resulted primarily from cash dividends paid of \$1,782,000 and distribution of \$73,000 to the minority interest.

The Company's capital resource commitments at May 31, 2007 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 2007. The Company has available a revolving line of credit of \$5,000,000 with a major money center bank through October 6, 2007. As of May 31, 2007, no amounts were outstanding under this line of credit.

### Tabular Disclosure of Contractual Obligations

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Payments Due By Period

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| Contractual Obligations<br>-----  | Total<br>-----       | Less than 1 Year<br>----- | 1-3 Years<br>-----   | 3-5 Years<br>-----  |
|---|----------------------|---------------------------|----------------------|---------------------|
| Long-Term Debt.....   | --                   | --                        | --                   | --                  |
| Capital Lease Obligations.....  | --                   | --                        | --                   | --                  |
| Operating Leases.....   | 1,118,000            | 336,000                   | 444,000              | 315,000             |
| Purchase Obligations.....   | --                   | --                        | --                   | --                  |
| Employment Agreements.....  | 1,400,000            | 350,000                   | 700,000              | 350,000             |
| Other Long-Term Liabilities<br>Reflected on the Registrant's<br>Balance Sheet under GAAP..... | --                   | --                        | --                   | --                  |
| Total.....  | \$2,518,000<br>===== | \$ 686,000<br>=====       | \$1,144,000<br>===== | \$ 665,000<br>===== |

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### Impact of New Accounting Standards -----

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 - "Accounting for Uncertainty in Income Taxes" (FIN 48). This guidance is intended to provide increased consistency in the application of FASB Statement No. 109 - "Accounting for Income Taxes" by providing guidance with regard to the recognition and measurement of tax positions, and provide increased disclosure requirements. In particular, this interpretation requires uncertain tax positions to be recognized only if they are "more-likely-than-not" to be upheld based on their technical merits. Additionally, the measurement of the tax position will be based on the largest amount that is determined to have greater than a 50% likelihood of realization upon ultimate settlement. Any resulting cumulative effect of applying the provisions of FIN 48 upon adoption would be reported as an adjustment to the beginning balance of retained earnings (deficit) in the period of adoption. The Company does not expect the adoption of FIN 48 at the beginning of its fiscal 2008 year to have a material impact on its consolidated financial statements.

On September 15, 2006, the FASB issued SFAS No. 157, "Fair Value Measurements". SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. SFAS No. 157 provides guidance related to estimating fair value and requires expanded disclosures. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. The Company is evaluating SFAS No. 157 and its impact on the Company's 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

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based upon payment history and the customer's current credit worthiness, 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 upon our historical experience 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 DEFERRED TAX ASSETS

We regularly evaluate our ability to recover the reported amount of our deferred income taxes 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.

### Item 7A. Quantitative and Qualitative Disclosure About Market Risk

-----

The Company's earnings and cash flows are subject to fluctuations due to (i) changes in interest rates primarily affecting its income from the investment of available cash balances in money market funds and (ii) changes in market values of its investments in trading equity securities. Under its current policies, the Company does not use interest rate derivative instruments to manage exposure to interest rate changes. The Company's present exposure to changes in the market value of its investments in equity securities is not significant.

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### Item 8. Financial Statements.

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#### INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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## 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, 2007 and 2006 and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended May 31, 2007. We have also audited the financial statement schedule for each of the three years in the period ended May 31, 2007 as listed on Item 15(a)2. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule 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 financial statements and schedule 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 audits 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 financial statements and schedule, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. 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 at May 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three year period ended May 31, 2007 in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the schedule presents fairly, in all material respects, the information set forth therein.

/s/ BDO SEIDMAN, LLP

Melville, New York  
July 31, 2007

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TSR, INC. AND SUBSIDIARIES

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## CONSOLIDATED BALANCE SHEETS MAY 31, 2007 AND 2006

### ASSETS

|  | 2007         | 2006         |
|--|--------------|--------------|
|  | ----         | ----         |
| CURRENT ASSETS:                                      |              |              |
| Cash and cash equivalents (note 1 (d)) .....         | \$ 1,900,264 | \$ 2,660,739 |
| Marketable securities (note 1 (e)) .....             | 6,395,131    | 5,406,830    |
| Accounts receivable:                                 |              |              |
| Trade, net of allowance for doubtful accounts        |              |              |
| of \$355,000 in 2007 and 2006 .....                  | 8,156,651    | 8,272,963    |
| Other .....  | 99,015       | 90,172       |
|  | -----        | -----        |
|  | 8,255,666    | 8,363,135    |
| <br>   |              |              |
| Prepaid expenses .....                               | 54,928       | 48,793       |
| Prepaid and recoverable income taxes .....           | 153,618      | 320,156      |
| Deferred income taxes (note 2) .....                 | 145,000      | 150,000      |
|  | -----        | -----        |
| TOTAL CURRENT ASSETS .....                           | 16,904,607   | 16,949,653   |
|  | -----        | -----        |
| <br>EQUIPMENT AND LEASEHOLD IMPROVEMENTS, AT COST:   |              |              |
| Equipment .....                                      | 226,888      | 271,646      |
| Furniture and fixtures .....                         | 112,196      | 112,196      |
| Automobiles .....                                    | 19,665       | 128,859      |
| Leasehold improvements .....                         | 68,379       | 68,379       |
|  | -----        | -----        |
|  | 427,128      | 581,080      |
| <br>   |              |              |
| Less accumulated depreciation and amortization ..... | 380,838      | 544,946      |
|  | -----        | -----        |
|  | 46,290       | 36,134       |
| <br>   |              |              |
| MARKETABLE SECURITIES (NOTE 1(E)) .....              | 996,445      | 1,490,547    |
| OTHER ASSETS .....                                   | 49,653       | 49,653       |
| DEFERRED INCOME TAXES (NOTE 2) .....                 | 62,000       | 109,000      |
|  | -----        | -----        |
|  | \$18,058,995 | \$18,634,987 |
|  | =====        | =====        |

See accompanying notes to consolidated financial statements.

(Continued)

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## TSR, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS, CONTINUED MAY 31, 2007 AND 2006

### LIABILITIES AND STOCKHOLDERS' EQUITY

|                                   | 2007       | 2006       |
|-----------------------------------|------------|------------|
|                                   | ----       | ----       |
| CURRENT LIABILITIES:              |            |            |
| Accounts and other payables ..... | \$ 306,695 | \$ 209,840 |

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|   |              |              |
|---|--------------|--------------|
| Accrued and other liabilities:  |              |              |
| Salaries, wages and commissions .....   | 1,942,462    | 1,683,207    |
| Legal and professional fees .....   | 82,094       | 86,683       |
| Other .....   | 166,656      | 960,312      |
|   | 2,191,212    | 2,730,202    |
| Advances from customers .....   | 1,591,324    | 1,538,985    |
| Income taxes payable .....  | --           | 102,974      |
|   | 4,089,231    | 4,582,001    |
| TOTAL CURRENT LIABILITIES .....   |              |              |
| MINORITY INTEREST .....   | 17,500       | 31,751       |
| COMMITMENTS AND CONTINGENCIES (NOTES 5 AND 7)   |              |              |
| STOCKHOLDERS' EQUITY (NOTES 3 AND 7):   |              |              |
| Preferred stock, \$1.00 par value,<br>Authorized 1,000,000 shares; none issued .....          | --           | --           |
| Common stock, \$.01 par value, authorized<br>25,000,000 shares; issued 6,228,326 shares ..... | 62,283       | 62,283       |
| Additional paid-in capital .....  | 5,071,727    | 5,071,727    |
| Retained earnings .....   | 20,849,555   | 20,918,526   |
|   | 25,983,565   | 26,052,536   |
| Less: Treasury stock, 1,660,314 shares, at cost .....   | 12,031,301   | 12,031,301   |
|   | 13,952,264   | 14,021,235   |
| TOTAL STOCKHOLDERS' EQUITY .....  |              |              |
|   | \$18,058,995 | \$18,634,987 |
|   | \$18,058,995 | \$18,634,987 |

See accompanying notes to consolidated financial statements.

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### TSR, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME YEARS ENDED MAY 31, 2007, 2006 AND 2005

|  | 2007          | 2006       |
|--|---------------|------------|
|  | ----          | ----       |
| REVENUES, NET .....                                | \$ 49,688,576 | \$ 48,108, |
| COST OF SALES .....                                | 40,533,746    | 38,759,    |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES ..... | 7,229,832     | 7,640,     |
|  | 47,763,578    | 46,399,    |
| INCOME FROM OPERATIONS .....                       | 1,924,998     | 1,708,     |

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|  |              |           |
|--|--------------|-----------|
| OTHER INCOME (EXPENSE):  |              |           |
| Interest and dividend income .....   | 460,794      | 358,      |
| Realized and unrealized (loss) gain from<br>marketable securities, net ..... | 3,328        | (7,       |
| Minority interest in subsidiary operating profits .....                      | (55,327)     | (71,      |
|  | 408,795      | 279,      |
| INCOME BEFORE INCOME TAXES .....   | 2,333,793    | 1,987,    |
| PROVISION FOR INCOME TAXES (NOTE 2) .....                                    | 941,000      | 774,      |
| NET INCOME .....   | \$ 1,392,793 | \$ 1,213, |
| BASIC NET INCOME PER COMMON SHARE .....                                      | \$ 0.30      | \$ 0      |
| WEIGHTED AVERAGE NUMBER OF BASIC COMMON SHARES OUTSTANDING .....             | 4,568,012    | 4,568,    |
| DILUTED NET INCOME PER COMMON SHARE .....                                    | \$ 0.30      | \$ 0      |
| WEIGHTED AVERAGE NUMBER OF DILUTED COMMON SHARES<br>OUTSTANDING .....        | 4,568,012    | 4,568,    |

See accompanying notes to consolidated financial statements.

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TSR, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
YEARS ENDED MAY 31, 2007, 2006 AND 2005

|   | SHARES OF<br>COMMON<br>STOCK<br>----- | COMMON<br>STOCK<br>----- | ADDITIONAL<br>PAID-IN<br>CAPITAL<br>----- | RETAINED<br>EARNINGS<br>----- |
|---|---------------------------------------|--------------------------|---|-------------------------------|
| BALANCE AT MAY 31, 2004 .....                                   | 6,228,326                             | \$ 62,283                | \$ 5,079,027                              | \$ 22,081,995                 |
| NET INCOME .....  | --                                    | --                       | --  | 2,144,886                     |
| CASH DIVIDENDS PAID .....                                       | --                                    | --                       | --  | (2,740,807)                   |
| STOCK BASED COMPENSATION EXPENSE<br>(RECOVERY) (NOTE1(N)) ..... | --                                    | --                       | (7,300)                                   | --                            |
| BALANCE AT MAY 31, 2005 .....                                   | 6,228,326                             | 62,283                   | 5,071,727                                 | 21,486,074                    |
| NET INCOME .....  | --                                    | --                       | --  | 1,213,977                     |
| CASH DIVIDENDS PAID .....                                       | --                                    | --                       | --  | (1,781,525)                   |
| BALANCE AT MAY 31, 2006 .....                                   | 6,228,326                             | 62,283                   | 5,071,727                                 | 20,918,526                    |

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|                               |           |           |              |               |
|-------------------------------|-----------|-----------|--------------|---------------|
| NET INCOME .....              | --        | --        | --           | 1,392,793     |
| CASH DIVIDENDS PAID .....     | --        | --        | --           | (1,461,764)   |
|                               | -----     | -----     | -----        | -----         |
| BALANCE AT MAY 31, 2007 ..... | 6,228,326 | \$ 62,283 | \$ 5,071,727 | \$ 20,849,555 |
|                               | =====     | =====     | =====        | =====         |

See accompanying notes to consolidated financial statements.

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TSR, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED MAY 31, 2007, 2006 AND 2005

|   | 2007         |
|---|--------------|
|   | ----         |
| Cash flows from operating activities:   |              |
| Net Income .....  | \$ 1,392,793 |
| Adjustments to reconcile net income to net cash provided by operating activities: |              |
| Depreciation and amortization .....   | 26,066       |
| Realized and unrealized loss (gain) from marketable securities, net .....         | (3,328)      |
| Deferred income taxes .....   | 52,000       |
| Minority interest in subsidiary operating profits .....                           | 55,327       |
| Stock based compensation expense (recovery) .....                                 | --           |
| Recovery of bad debt expense .....  | --           |
| Changes in operating assets and liabilities:                                      |              |
| Accounts receivable-trade .....   | 116,312      |
| Other receivables .....   | (8,843)      |
| Prepaid expenses .....  | (6,135)      |
| Prepaid and recoverable income taxes .....  | 166,538      |
| Other assets .....  | --           |
| Accounts payable and accrued expenses .....                                       | (442,135)    |
| Advances from customers .....   | 52,339       |
| Income taxes payable .....  | (102,974)    |
|   | -----        |
| Net cash provided by operating activities .....                                   | 1,297,960    |
|   | -----        |
| CASH FLOWS FROM INVESTING ACTIVITIES:   |              |
| Proceeds from maturities and sales of marketable securities .....                 | 9,779,044    |
| Purchases of marketable securities .....  | (10,269,915) |
| Purchases of fixed assets .....   | (36,222)     |
|   | -----        |
| Net cash provided by (used in) investing activities .....                         | (527,093)    |
|   | -----        |
| CASH FLOWS FROM FINANCING ACTIVITIES:   |              |
| Distribution to minority interest .....   | (69,578)     |
| Cash dividends paid .....   | (1,461,764)  |
|   | -----        |
| Net cash used in financing activities .....                                       | (1,531,342)  |
|   | -----        |



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|  |              |
|--|--------------|
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS ..... | (760,475)    |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR .....       | 2,660,739    |
|  | -----        |
| CASH AND CASH EQUIVALENTS AT END OF YEAR .....             | \$ 1,900,264 |
|  | =====        |
| <br>SUPPLEMENTAL DISCLOSURE:                               |              |
| Income taxes paid .....                                    | \$ 825,000   |
|  | =====        |

See accompanying notes to consolidated financial statements

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### TSR, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MAY 31, 2007, 2006 AND 2005

(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 and state and local government agencies located primarily in the Metropolitan New York area. The Company provides its clients with technical computer personnel to supplement their in-house information technology capabilities. In fiscal 2007, two customers accounted for more than 10% of the Company's revenues, constituting 19.1% and 11.3%, respectively. In fiscal 2006, two customers accounted for more than 10% of the Company's revenues, constituting 16.8% and 13.0% of revenues, respectively. In fiscal 2005, two customers accounted for more than 10% of the Company's revenues, constituting 22.2% and 13.5% of revenues, respectively. The accounts receivable associated with the Company's largest customer was \$1,610,000, \$1,286,000 and \$1,360,000 at May 31, 2007, 2006 and 2005, respectively. The accounts receivable associated with the Company's second largest customer was \$1,197,000, \$1,349,000 and \$666,000 at May 31, 2007, 2006, and 2005, respectively. 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. Accordingly, such revenues are recognized as services are provided. Advances from customers represent amounts received from customers prior to the Company's completion of the related services, credit balances from overpayments and certain escheat liabilities.

Reimbursements received by the Company for out-of-pocket expenses are characterized as revenue in accordance with Emerging Issues Task Force (EITF) Issue 01-14 "Income Statement Characterization of Reimbursements

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Received for 'Out-of-Pocket' Expenses Incurred."

(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, 2007 and 2006:

|                          | 2007<br>----- | 2006<br>----- |
|--------------------------|---------------|---------------|
| Cash in banks .....      | \$ 390,370    | \$ 286,625    |
| Money Market Funds ..... | 1,509,894     | 2,374,114     |
|                          | -----         | -----         |
|                          | \$1,900,264   | \$2,660,739   |
|                          | =====         | =====         |

(Continued)

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TSR, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED  
MAY 31, 2007, 2006 AND 2005

(E) MARKETABLE SECURITIES

The Company accounts for its marketable securities in accordance with Statement of Financial Accounting Standards ("SFAS") No. 115 "Accounting for Certain Investments in Debt and Equity Securities." Accordingly, 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 US Treasury securities to maturity (which maturities range up to nineteen months), such securities have been classified as held-to-maturity and are carried at amortized cost. The Company's equity securities are classified as trading securities, which are carried at fair value, with unrealized gains and losses included in earnings. The Company's marketable securities are summarized as follows:

|       |                            | Amortized<br>Cost<br>----- | Gross<br>Unrealized<br>Holding<br>Gains<br>----- | Gross<br>Unrealized<br>Holding<br>Losses<br>----- |
|-------|----------------------------|----------------------------|--|---|
|       | CURRENT<br>-----           |                            |  |   |
| 2007: | US TREASURY SECURITIES.... | \$ 6,377,387               | \$ --  | \$ --   |
|       | EQUITY SECURITIES .....    | 16,866                     | \$ --  | 878   |
|       |                            | -----                      | -----  | -----   |
|       |                            | \$ 6,394,253               | \$ --  | \$ 878  |
|       |                            | =====                      | =====  | =====   |
|       | LONG TERM<br>-----         |                            |  |   |
|       | US TREASURY SECURITIES ... | \$ 996,445                 | \$ --  | \$ --   |
|       |                            | =====                      | =====  | =====   |
|       | Current<br>-----           |                            |  |   |
| 2006: | US Treasury securities.... | \$ 5,392,414               | \$ --  | \$ --   |
|       | Equity securities .....    | 16,866                     | --   | (2,450)   |

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|                            |              |       |            |
|----------------------------|--------------|-------|------------|
|                            | \$ 5,409,280 | \$ -- | \$ (2,450) |
| Long Term                  |              |       |            |
| US Treasury securities ... | \$ 1,490,547 | \$ -- | \$ --      |

(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, credit worthiness 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.

(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 (which for the Company equals its net income) by the weighted average number of common shares outstanding, and diluted net income per common share adds the dilutive effect of stock options and other common stock equivalents, if any. No antidilutive stock options covering shares of common stock have been omitted from the calculation of diluted net income per common share for the fiscal year ended May 31, 2007, 2006 and 2005, respectively.

(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.

(Continued)

TSR, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED  
 MAY 31, 2007, 2006 AND 2005

(J) FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosures About Fair Value of 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 financial statements approximate fair value because of the short-term maturities of these instruments. The fair value of

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marketable securities is based upon quoted market values at the end of a period.

### (K) USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles 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 revenues 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) COMPREHENSIVE INCOME

The Company's net income equaled comprehensive income in fiscal 2007, 2006 and 2005.

### (N) STOCK OPTIONS

On July 28, 2003 the Company paid a large nonrecurring cash dividend of \$2.00 per share to shareholders of record as of July 11, 2003. The dividend paid amounted to \$9,088,024. Guidance under Emerging Issues Task Force (EITF) 00-23, ISSUES RELATED TO THE ACCOUNTING FOR STOCK COMPENSATION UNDER APB OPINION NO.25 AND FASB INTERPRETATION NO.44, required modification for outstanding stock options by adjusting the price and/or the number of shares under a fixed stock option award as a result of a large nonrecurring cash dividend. The Company did not adjust the terms of any outstanding stock options and, given the circumstances, a new measurement date and variable accounting treatment was required for its outstanding options at the dividend payment date. The Company had 10,000 such outstanding options, all of which were vested, as of May 31, 2005 which were subject to variable accounting treatment. Accordingly, the Company recorded a non-cash net recovery of \$7,300 for fiscal 2005. These options expired in June 2005.

The Company's one stock-based employee compensation plan expired on April 30, 2007. Effective June 1, 2006, the Company accounts for all transactions under which employees receive shares of stock or other equity instruments in the Company in accordance with the revised provisions of SFAS No. 123, "Statement of Financial Accounting Standards No. 123 (FAS123 (R))," which requires that the fair market value of all share based payment transactions be recognized in the financial statements. This Statement establishes fair value as the measurement objective in accounting for share based payment arrangements and requires all entities to apply a fair based measurement method in accounting for share based transactions with employees except for equity instruments held by employee share ownership plans. The Company adopted FAS 123(R) at the beginning of fiscal 2007. The Company has not issued any share based payments in fiscal 2007.

The Company previously accounted for share-based employee compensation in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees". All options granted under the plan had an exercise price equal to the market value of the

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underlying common stock, and the number of shares represented by such options were known and fixed, on the date of grant. However, as a result of the large nonrecurring cash dividend discussed above, the remaining outstanding 10,000 options were treated as variable options until their expiration in June 2005. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123 ACCOUNTING FOR STOCK-BASED COMPENSATION.

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TSR, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED  
MAY 31, 2007, 2006 AND 2005

|   | Year Ended May 31,<br>2006 | 2005         |
|---|----------------------------|--------------|
|   | ----                       | ----         |
| Net income:   |                            |              |
| As reported.....  | \$ 1,213,977               | \$ 2,144,886 |
| <br>Add: Stock-based employee compensation<br>expense (recovery) included in reported<br>net income, net of related tax effect..... | <br>--                     | <br>(7,300)  |
|   | -----                      | -----        |
| Proforma net income.....  | \$ 1,213,977               | \$ 2,137,586 |
|   | =====                      | =====        |
| Basic and diluted net income per share:   |                            |              |
| As reported.....  | \$ 0.27                    | \$ 0.47      |
|   | =====                      | =====        |
| Proforma SFAS 123.....  | \$ 0.27                    | \$ 0.47      |
|   | =====                      | =====        |

There were no options granted in fiscal 2007, 2006 or 2005 and all previously issued options expired in June 2005.

(O) IMPACT OF NEW ACCOUNTING STANDARDS

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 - "Accounting for Uncertainty in Income Taxes" (FIN 48). This guidance is intended to provide increased consistency in the application of FASB Statement No. 109 - "Accounting for Income Taxes" by providing guidance with regard to the recognition and measurement of tax positions, and provide increased disclosure requirements. In particular, this interpretation requires uncertain tax positions to be recognized only if they are "more-than-likely-not" to be upheld based on their technical merits. Additionally, the measurement of the tax position will be based on the largest amount that is determined to have greater than a 50% likelihood of realization upon ultimate settlement. Any resulting cumulative effect of applying the provisions of FIN 48 upon adoption would be reported as an adjustment to the beginning balance of retained earnings (deficit) in the period of adoption. The Company does not expect the adoption of FIN 48 at the beginning of its fiscal 2008 year to have a material impact on its consolidated financial statements.

On September 15, 2006, the FASB issued SFAS No. 157, "Fair Value Measurements". SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. SFAS No. 157 provides guidance related to estimating fair value and requires expanded disclosures. The standard does not expand the use of fair value in any new circumstances. The Company is evaluating SFAS No. 157 and its impact on the Company's consolidated financial statements.

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(P) CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities and accounts receivable. The Company places its cash equivalents with financial institutions and brokerage houses. The Company has substantially all of its cash in three bank accounts. The balances are insured by FDIC up to \$100,000. Such cash balances, at times, may exceed FDIC limits. The Company holds its marketable securities, which consist primarily of United States Treasury Securities, directly with the Treasury and in brokerage accounts. The Company has not experienced losses in any such accounts. The Company's accounts receivables represent approximately 70 accounts with open balances of which, the top 2 customers, as a percentage of revenue, consisted of 19.7% and 14.7% of the net accounts receivable balance at May 31, 2007, respectively.

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TSR, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED  
 MAY 31, 2007, 2006 AND 2005

(2) INCOME TAXES

A reconciliation of the provisions for income taxes computed at the federal statutory rates for fiscal 2007, 2006, and 2005 to the reported amounts is as follows:

|  | 2007       |       | 2006       |       |       |
|--|------------|-------|------------|-------|-------|
|  | AMOUNT     | %     | Amount     | %     |       |
|  | -----      | ---   | -----      | ---   |       |
| Amounts at statutory federal tax rate  | \$ 793,000 | 34.0% | \$ 676,000 | 34.0% | \$    |
| State and local taxes, net of          |            |       |            |       |       |
| federal income tax effect ....         | 160,000    | 6.8   | 115,000    | 5.8   |       |
| Non-deductible expenses, and other ... | (12,000)   | (0.5) | (17,000)   | (0.9) |       |
|  | -----      | ----  | -----      | ----  | ----- |
|  | \$ 941,000 | 40.3% | \$ 774,000 | 38.9% | \$    |
|  | =====      | ===== | =====      | ===== | ===== |

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

|                     | Federal      | State      | Total        |
|---------------------|--------------|------------|--------------|
|                     | -----        | -----      | -----        |
| 2007: CURRENT ..... | \$ 660,000   | \$ 229,000 | \$ 889,000   |
| DEFERRED .....      | 39,000       | 13,000     | 52,000       |
|                     | -----        | -----      | -----        |
|                     | \$ 699,000   | \$ 242,000 | \$ 941,000   |
|                     | =====        | =====      | =====        |
| 2006: Current ..... | \$ 551,000   | \$ 154,000 | \$ 705,000   |
| Deferred .....      | 49,000       | 20,000     | 69,000       |
|                     | -----        | -----      | -----        |
|                     | \$ 600,000   | \$ 174,000 | \$ 774,000   |
|                     | =====        | =====      | =====        |
| 2005: Current ..... | \$ 1,126,000 | \$ 480,000 | \$ 1,606,000 |
| Deferred .....      | (5,000)      | --         | (5,000)      |

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|              |            |              |
|--------------|------------|--------------|
| -----        | -----      | -----        |
| \$ 1,121,000 | \$ 480,000 | \$ 1,601,000 |
| =====        | =====      | =====        |

The tax effects of temporary differences that give rise to significant portions of the deferred income tax assets at May 31, 2007 and 2006 are as follows:

|  |           |           |
|--|-----------|-----------|
|  | 2007      | 2006      |
|  | ----      | ----      |
| Allowance for doubtful accounts receivable ..... | \$145,000 | \$150,000 |
| Equipment and leasehold improvement              |           |           |
| Depreciation and amortization .....              | 14,000    | 54,000    |
| Acquired client relationships .....              | 48,000    | 55,000    |
|  | -----     | -----     |
| Total deferred income tax assets ....            | \$207,000 | \$259,000 |
|  | =====     | =====     |

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.

(Continued)

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TSR, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED  
MAY 31, 2007, 2006 AND 2005

(3) STOCK OPTIONS

The 1997 Employee Stock Option Plan, which expired on April 30, 2007, provided for the granting of options to purchase up to 800,000 shares of the Company's common stock at prices equal to fair market values at the grant dates. Options were exercisable as determined on the date of the grant and expired on the fifth anniversary of the date of grant.

|  | STOCK OPTIONS OUTSTANDING |          |          |
|--|---------------------------|----------|----------|
|  |                           | EXERCISE | WEIGHTED |
|  | SHARES                    | PRICE    | AVERAGE  |
|  |                           |          | PRICE    |
| Outstanding at May 31, 2005.....       | 10,000                    | \$ 5.53  | \$ 5.53  |
|  | =====                     | =====    | =====    |
| Options expired .....                  | (10,000)                  | \$ 5.53  | \$ 5.53  |
|  | =====                     | =====    | =====    |
| OUTSTANDING AT MAY 31, 2006 AND 2007.. | 0                         | \$ 0     | \$ 0     |
|  | =====                     | =====    | =====    |

(4) LINE OF CREDIT

The Company has an available line of credit of \$5,000,000 with a major money center bank through October 6, 2007. As of May 31, 2007, no amounts were outstanding under this line of credit. The rate of interest on amounts drawn against the line of credit will be either the Eurodollar Rate plus 1% or the Prime Rate, determined at the time of the advance. The Company intends to renew this facility on or before its current expiration.

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(5) COMMITMENTS AND CONTINGENCIES

A summary of noncancellable long-term operating lease commitments for facilities as of May 31, 2007 follows:

| PERIOD<br>-----  | AMOUNT<br>----- |
|------------------|-----------------|
| Less than        |                 |
| 1 year.....      | \$ 336,000      |
| 1-3 years.....   | 444,000         |
| 3-5 years.....   | 315,000         |
| Over 5 years.... | 23,000          |
|                  | -----           |
| Total....        | \$ 1,118,000    |

Total rent expenses under all lease agreements amounted to \$340,000, \$340,000 and \$369,000 in fiscal 2007, 2006 and 2005.

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 financial position of the Company.

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TSR, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, CONTINUED  
MAY 31, 2007, 2006 AND 2005

(6) UNAUDITED QUARTERLY FINANCIAL DATA

The following is a summary of unaudited quarterly operating results for the fiscal years ended May 31, 2007 and 2006.

|   | (Amounts in Thousands, except Per Share Data) |           |           |           |
|---|---|-----------|-----------|-----------|
|   | Fiscal 2007                                   |           |           |           |
|   | First   | Second    | Third     | Fourth    |
| Revenues .....  | \$ 12,376                                     | \$ 12,626 | \$ 11,774 | \$ 12,913 |
| Gross Profit .....  | 2,377   | 2,369     | 2,052     | 2,357     |
| Net Income .....  | 444   | 413       | 201       | 335       |
| Basic and Diluted Net Income<br>per Common Share .....        | \$ 0.10                                       | \$ 0.09   | \$ 0.04   | \$ 0.07   |
|   | (Amounts in Thousands, except Per Share Data) |           |           |           |
|   | Fiscal 2006                                   |           |           |           |
|   | First   | Second    | Third     | Fourth    |
| Revenues .....  | \$ 12,465                                     | \$ 11,829 | \$ 11,595 | \$ 12,220 |
| Gross Profit .....  | 2,526   | 2,369     | 2,108     | 2,346     |
| Net Income (Loss) .....                                       | 474   | 484       | 289       | (33)      |
| Basic and Diluted Net Income<br>(Loss) per Common Share ..... | \$ 0.10                                       | \$ 0.11   | \$ 0.06   | \$ (0.01) |

(7) SUBSEQUENT EVENT

On August 3, 2007, the Board of Directors of the Company announced that a



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regular quarterly cash dividend of \$0.08 per share will be paid on September 12, 2007 to shareholders of record as of August 24, 2007. This dividend will amount to approximately \$365,000 and will be paid from the Company's cash and marketable securities.

(8) MAJOR CUSTOMER

In June 2006, the New York State Office of General Services, Procurement Services Group ("OGS") terminated its contract with the Company. The OGS actions were due to the report of an investigation by the Office of the Special Commissioner of Investigation of the New York City Department of Education ("DOE"). The investigative report concluded that the Company operated improperly from 2001 through the spring of 2003 by using a subcontracting arrangement to obtain programmers for positions with the DOE. The subcontracting was with a small firm that was owned by an individual who worked as a consultant under contract at the DOE in a supervising capacity and sometimes was involved in decisions to select consultants that financially benefited both him and the Company. The investigative report also suggested that the Company received advanced information as to new positions from this individual and that the subcontracting increased the costs to the DOE since two firms, instead of one, profited from this arrangement.

All new placements with the DOE, including renewals of existing placements, were being made under this OGS contract prior to its termination. As a result the Company will not be able to make new placements or renew existing placements with the DOE. The DOE accounted for approximately 13% of the Company's revenues during the Company's fiscal year ended May 31, 2006 and 4% during fiscal 2007. At May 31, 2006 the Company had forty-one consultants placed with the DOE. As a result of the termination, consultants placed with the DOE who came up for renewal were not renewed. The last remaining consultants were terminated in April 2007.

DOE also asserted a claim against the Company for a reimbursement due to the Company's subcontracting without written authorization. While the Company believes that its subcontracting did not result in overcharges to DOE, it has settled the matter in order to avoid the expense and uncertainty of litigation. The related \$900,000 reserve established at May 31, 2006 was sufficient for the settlement which was finalized in May, 2007.

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Item 9. Changes in and Disagreements with Accountants on Accounting and

-----  
Financial Disclosure  
-----

None

Item 9A. Controls and Procedures  
-----

DISCLOSURE CONTROLS AND PROCEDURES. The Company conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")). Based on this evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective.

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INTERNAL CONTROL OVER FINANCIAL REPORTING. There was no change in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the Company's most recently reported completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### Item 9B. Other Information

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None

## PART III

### Item 10. Directors and Executive Officers of the Company.

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The information required by this Item 10 is incorporated by reference to the Company's definitive proxy statement in connection with the 2007 Annual Meeting of Stockholders.

### Item 11. Executive Compensation.

-----

The information required by this Item 11 is incorporated by reference to the Company's definitive proxy statement in connection with the 2007 Annual Meeting of Stockholders.

### Item 12. Security Ownership of Certain Beneficial Owners and Management.

-----

The information required by this Item 12 is incorporated by reference to the Company's definitive proxy statement in connection with the 2007 Annual Meeting of Stockholders.

### Item 13. Certain Relationships and Related Transactions.

-----

The information required by this Item 13 is incorporated by reference to the Company's definitive proxy statement in connection with the 2007 Annual Meeting of Stockholders.

### Item 14. Principal Accountant Fees and Services

-----

The information required by this Item 14 is incorporated by reference to the Company's definitive proxy statement in connection with the 2007 Annual Meeting of Stockholders.

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## PART IV

### Item 15. Exhibits and Financial Statement Schedules.

-----

(a) The following documents are filed as part of this report:

1. The financial statements as indicated in the index set forth on page 17.
2. Financial statement schedule:

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|  |      |
|--|------|
| Schedule supporting consolidated financial statements: | Page |
|  | ---- |
| Schedule II - Valuation and Qualifying Accounts .....  | 32   |

Schedules other than those listed above have been omitted, since they are either not applicable, not required or the information is included elsewhere herein.

3. Exhibits as listed in Exhibit Index on page 34.

TSR, INC. AND SUBSIDIARIES

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

|                                       | Balance at<br>Beginning<br>of Period | Charged to<br>Cost and<br>Expense<br>(Recovery) | Deductions/<br>Write-Offs | Balance<br>End of |
|---------------------------------------|--------------------------------------|---|---------------------------|-------------------|
| Year ended May 31, 2007:              |                                      |   |                           |                   |
| Allowance for doubtful accounts ..... | \$355,000<br>=====                   | \$ --<br>=====                                  | \$ --<br>=====            | \$355,<br>=====   |
| Year ended May 31, 2006:              |                                      |   |                           |                   |
| Allowance for doubtful accounts ..... | \$430,000<br>=====                   | \$ (75,000)<br>=====                            | \$ --<br>=====            | \$355,<br>=====   |
| Year ended May 31, 2005:              |                                      |   |                           |                   |
| Allowance for doubtful accounts ..... | \$430,000<br>=====                   | \$ --<br>=====                                  | \$ --<br>=====            | \$430,<br>=====   |

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Signatures

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Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the Undersigned, thereunto duly authorized.

TSR, INC.

By: /s/ J.F. Hughes

-----  
J. F. Hughes, Chairman

Dated: August 7, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

/s/ J.F. Hughes

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J. F. Hughes, President,  
Treasurer and Director

/s/ John G. Sharkey  
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John G. Sharkey, Vice President, Finance,  
Controller and Secretary

/s/ John H. Hochuli, Jr  
-----

John H. Hochuli, Jr., Director

/s/ James J. Hill  
-----

James J. Hill, Director

/s/ Christopher Hughes  
-----

Christopher Hughes, Senior Vice President  
and Director

/s/ Robert A. Esernio  
-----

Robert A. Esernio, Director

/s/ Raymond A. Roel  
-----

Raymond A. Roel, Director

Dated: August 7, 2007

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TSR, INC. AND SUBSIDIARIES  
EXHIBIT INDEX  
FORM 10-K, MAY 31, 2007

| Exhibit<br>Number<br>----- | EXHIBIT   | Sequential<br>Page #<br>----- |
|----------------------------|---|-------------------------------|
| 3.1                        | Articles of Incorporation for the Company, as amended.<br>Incorporated by reference to Exhibit 3.1 to the Annual<br>Report on Form 10-K filed by the Company for the fiscal year<br>ended May 31, 1998. | N/A                           |
| 3.2                        | Bylaws of the Company, as amended incorporated by reference<br>to Exhibit 3.2 to the Annual Report on Form 10-K filed by<br>the Company for the fiscal year ended May 31, 1998.                         | N/A                           |
| 10.1                       | Employment Agreement between TSR, Inc. and Christopher  |                               |

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|      |   |     |
|------|---|-----|
|      | Hughes, dated as of March 1, 2007. Incorporated by reference to the Form 8-K filed by the Company on March 6, 2007.   | N/A |
| 10.2 | 1997 Employee Stock Option Plan, incorporated by reference to Exhibit 10.2 to the annual Report on Form 10-K filed by Company for the fiscal year ended May 31, 1997.   | N/A |
| 10.3 | Form of Employee Stock Option Agreement, incorporated by reference to Exhibit 10.3 to the Annual report on Form 10-K filed by the Company for the fiscal year ended May 31, 1997.   | N/A |
| 10.4 | Employment Agreement dated June 1, 2002 between the Company and Joseph F. Hughes, incorporated by reference to Exhibit N/A 10.4 to the Annual Report on Form 10-K filed by the Company for the fiscal year ended May 31, 2002.  | N/A |
| 10.5 | Revolving Credit Agreement dated October 6, 1997 among TSR Consulting Services, Inc., TSR, Inc., Catch/21 Enterprises Incorporated and the Chase Manhattan Bank, incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q filed by the Company for the quarter ended August 31, 1997. | N/A |
| 10.6 | Employment Agreement dated June 1, 2005 between the Company and John G. Sharkey incorporated by reference to Exhibit 10.1 to the Report on Form 8-K filed by the Company on July 26, 2005.  | N/A |
| 21   | List of Subsidiaries  | 35  |
| 31.1 | Certification by J.F. Hughes Pursuant to Securities Exchange Act Rule 13a-14  | 36  |
| 31.2 | Certification by John G. Sharkey Pursuant to Securities Exchange Act Rule 13a-14  | 37  |
| 32.1 | Certification of J.F. Hughes Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  | 38  |
| 32.2 | Certification of John G. Sharkey Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  | 39  |