SCHMITT INDUSTRIES INC
Form 10-Q
January 13, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: November 30, 2014

Or

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

For the transition period from: ________ To: ________

Commission File Number: 000-23996

SCHMITT INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Oregon	**93-1151989**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification Number)**

2765 NW Nicolai Street, Portland, Oregon 97210-1818

(Address of principal executive offices) (Zip Code)

(503) 227-7908

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company x

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

The number of shares of each class of common stock outstanding as of December 31, 2014

Common stock, no par value	2,995,910

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SCHMITT INDUSTRIES, INC.

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	November 30, 2014	May 31, 2014
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,707,481	$ 1,510,565
Accounts receivable, net	2,540,227	2,235,194
Inventories	4,793,479	4,789,822
Prepaid expenses	110,870	152,237
Income taxes receivable	1,726	1,339
	9,153,783	8,689,157
Property and equipment, net	1,128,160	1,191,591
Other assets		
Intangible assets, net	880,177	943,643
TOTAL ASSETS	$ 11,162,120	$ 10,824,391
LIABILITIES & STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 674,097	$ 512,219
Accrued commissions	269,530	204,772
Accrued payroll liabilities	121,023	127,035
Other accrued liabilities	554,656	366,848
Income taxes payable	0	210
Total current liabilities	1,619,306	1,211,084
Stockholders equity		
Common stock, no par value, 20,000,000 shares authorized, 2,995,910 shares issued and outstanding at November 30, 2014 and May 31, 2014	10,465,223	10,438,750
Accumulated other comprehensive loss	(342,246)	(263,337)
Accumulated deficit	(580,163)	(562,106)

Total stockholders equity		9,542,814	9,613,307
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	11,162,120	$ 10,824,391

The accompanying notes are an integral part of these financial statements.

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SCHMITT INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

FOR THE THREE AND SIX MONTHS ENDED NOVEMBER 30, 2014 AND 2013

(UNAUDITED)

	Three Months Ended November 30,		Six Months Ended November 30,	
	2014	2013	2014	2013
Net sales	$ 3,151,504	$ 3,143,052	$ 6,200,792	$ 6,042,499
Cost of sales	1,597,326	1,675,184	3,183,047	3,243,509
Gross profit	1,554,178	1,467,868	3,017,745	2,798,990
Operating expenses:				
General, administration and sales	1,500,328	1,507,046	2,838,352	2,858,748
Research and development	124,651	112,096	197,095	238,860
Total operating expenses	1,624,979	1,619,142	3,035,447	3,097,608
Operating loss	(70,801)	(151,274)	(17,702)	(298,618)
Other income (loss), net	3,336	(9,546)	4,397	(6,093)
Loss before income taxes	(67,465)	(160,820)	(13,305)	(304,711)
Provision for income taxes	2,375	2,381	4,752	5,049
Net loss	$ (69,840)	$ (163,201)	$ (18,057)	$ (309,760)
Net loss per common share:				
Basic	$ (0.02)	$ (0.05)	$ (0.01)	$ (0.10)
Weighted average number of common shares, basic	2,995,910	2,990,910	2,995,910	2,990,910
Diluted	$ (0.02)	$ (0.05)	$ (0.01)	$ (0.10)
Weighted average number of common shares, diluted	2,995,910	2,990,910	2,995,910	2,990,910
Comprehensive loss				
Net loss	$ (69,840)	$ (163,201)	$ (18,057)	$ (309,760)
Foreign currency translation adjustment	(50,785)	49,324	(78,909)	52,924
Total comprehensive loss	$ (120,625)	$ (113,877)	$ (96,966)	$ (256,836)

The accompanying notes are an integral part of these financial statements.

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SCHMITT INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED NOVEMBER 30, 2014 AND 2013

(UNAUDITED)

	Six Months Ended November 30, 2014	2013
Cash flows relating to operating activities		
Net loss	$ (18,057)	$ (309,760)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	139,950	175,304
Stock based compensation	26,473	24,932
(Increase) decrease in:		
Accounts receivable	(327,467)	(171,220)
Inventories	(21,292)	410,457
Prepaid expenses	40,062	89,619
Income taxes receivable	(387)	26,486
Increase (decrease) in:		
Accounts payable	165,338	(376,035)
Accrued liabilities and customer deposits	250,603	(73,194)
Income taxes payable	(210)	0
Net cash provided by (used in) operating activities	255,013	(203,411)
Cash flows relating to investing activities		
Purchases of property and equipment	(13,050)	(1,436)
Net cash used in investing activities	(13,050)	(1,436)
Cash flows relating to financing activities		
Increase in line of credit	0	400,000
Net cash provided by financing activities	0	400,000
Effect of foreign exchange translation on cash	(45,047)	11,411
Increase in cash and cash equivalents	196,916	206,564
Cash and cash equivalents, beginning of period	1,510,565	1,909,071
Cash and cash equivalents, end of period	$ 1,707,481	$ 2,115,635

Supplemental disclosure of cash flow information

Cash paid during the period for income taxes	$	5,353	$	5,064
Cash paid during the period for interest	$	1,933	$	7,178

The accompanying notes are an integral part of these financial statements.

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SCHMITT INDUSTRIES, INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

FOR THE SIX MONTHS ENDED NOVEMBER 30, 2014

(UNAUDITED)

	Shares	Amount	Accumulated other comprehensive loss	Accumulated deficit	Total
Balance, May 31, 2014	2,995,910	$ 10,438,750	$ (263,337)	$ (562,106)	$ 9,613,307
Stock-based compensation	0	26,473	0	0	26,473
Net loss	0	0	0	(18,057)	(18,057)
Other comprehensive loss	0	0	(78,909)	0	(78,909)
Balance, November 30, 2014	2,995,910	$ 10,465,223	$ (342,246)	$ (580,163)	$ 9,542,814

The accompanying notes are an integral part of these financial statements.

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SCHMITT INDUSTRIES, INC.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Note 1:

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial information included herein has been prepared by Schmitt Industries, Inc. (the Company or Schmitt) and its wholly owned subsidiaries. In the opinion of management, the accompanying unaudited Consolidated Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly its financial position as of November 30, 2014 and its results of operations and its cash flows for the periods presented. The consolidated balance sheet at May 31, 2014 has been derived from the Annual Report on Form 10-K for the fiscal year ended May 31, 2014. The accompanying unaudited financial statements and related notes should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended May 31, 2014. Operating results for the interim periods presented are not necessarily indicative of the results that may be experienced for the fiscal year ending May 31, 2015.

Revenue Recognition

The Company recognizes revenue for sales and billing for freight charges upon delivery of the product to the customer at a fixed and determinable price with a reasonable assurance of collection, passage of title to the customer as indicated by shipping terms and fulfilment of all significant obligations, pursuant to the guidance provided by Accounting Standards Codification (ASC) Topic 605. For sales to all customers, including manufacturer representatives, distributors or their third-party customers, these criteria are met at the time product is shipped. When other significant obligations remain after products are delivered, revenue is recognized only after such obligations are fulfilled. In addition, judgments are required in evaluating the credit worthiness of our customers. Credit is not extended to customers and revenue is not recognized until we have determined that collectability is reasonably assured.

Financial Instruments

The carrying value of all other financial instruments potentially subject to valuation risk (principally consisting of cash and cash equivalents, accounts receivable, accounts payable and the line of credit) also approximates fair value because of their short-term maturities.

Accounts Receivable

The Company maintains credit limits for all customers based upon several factors, including but not limited to financial condition and stability, payment history, published credit reports and use of credit references. Management performs various analyses to evaluate accounts receivable balances to ensure recorded amounts reflect estimated net realizable value. This review includes using accounts receivable agings, other operating trends and relevant business conditions, including general economic factors, as they relate to each of the Company s domestic and international customers. If these analyses lead management to the conclusion that potential significant accounts are uncollectible, a reserve is provided. The allowance for doubtful accounts was $59,321 and $63,297 as of November 30, 2014 and

May 31, 2014, respectively.

Inventories

Inventories are valued at the lower of cost or market with cost determined on the average cost basis. Costs included in inventories consist of materials, labor and manufacturing overhead, which are related to the purchase or production of inventories. Write-downs, when required, are made to reduce excess inventories to their net realizable values. Such estimates are based on assumptions regarding future demand and market conditions. If actual conditions become less favorable than the assumptions used, an additional inventory write-down may be required. As of November 30, 2014 and May 31, 2014, inventories consisted of:

	November 30, 2014	May 31, 2014
Raw materials	$ 2,092,996	$ 1,888,985
Work-in-process	1,033,600	994,009
Finished goods	1,666,883	1,906,828
	$ 4,793,479	$ 4,789,822

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Property and Equipment

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over estimated useful lives of three to seven years for furniture, fixtures and equipment; three years for vehicles; and twenty-five years for buildings and improvements. As of November 30, 2014 and May 31, 2014, property and equipment consisted of:

	November 30, 2014	May 31, 2014
Land	$ 299,000	$ 299,000
Buildings and improvements	1,814,524	1,805,951
Furniture, fixtures and equipment	1,373,248	1,370,131
Vehicles	86,838	86,838
	3,573,610	3,561,920
Less accumulated depreciation	(2,445,450)	(2,370,329)
	$ 1,128,160	$ 1,191,591

Note 2:

LINE OF CREDIT

The Company had a $2 million bank line of credit secured by U.S. accounts receivable, inventories, general intangibles and a depository account. The line of credit was subject to certain covenant requirements if draws on the line were executed. Interest was payable at the bank s prime rate or LIBOR plus 2.0%. The term on the line of credit expired on September 1, 2014, and the Company chose not to renew the line. The outstanding balance on the line of credit was $0 at May 31, 2014.

Note 3:

STOCK OPTIONS AND STOCK-BASED COMPENSATION

Stock-based compensation includes expense charges for all stock-based awards to employees and directors granted under the Company s stock option plan. Stock-based compensation recognized during the period is based on the portion of the grant date fair value of the stock-based award that will vest during the period, adjusted for expected forfeitures. Compensation cost for all stock-based awards is recognized using the straight-line method. The Company uses the Black-Scholes option pricing model as its method of valuation for stock-based awards. The Black-Scholes option pricing model requires the input of highly subjective assumptions, and other reasonable assumptions could provide differing results. These variables include, but are not limited to:

Risk-Free Interest Rate. The Company bases the risk-free interest rate on the implied yield currently available on U.S. Treasury issues with an equivalent remaining term approximately equal to the expected life of the award.

Expected Life. The expected life of awards granted represents the period of time that they are expected to be outstanding. The Company determines the expected life based on historical experience with similar awards, giving consideration to the contractual terms, vesting schedules and pre-vesting and post-vesting forfeitures.

Expected Volatility. The Company estimates the volatility of its common stock at the date of grant based on the historical volatility of its common stock. The volatility factor the Company uses is based on its historical stock prices over the most recent period commensurate with the estimated expected life of the award. These historical periods may exclude portions of time when unusual transactions occurred.

Expected Dividend Yield. The Company does not anticipate paying any cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield of zero.

Expected Forfeitures. The Company uses relevant historical data to estimate pre-vesting option forfeitures. The Company records stock-based compensation only for those awards that are expected to vest.

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To determine stock-based compensation expense recognized for those options granted during the six months ended November 30, 2014 and 2013, the Company has computed the value of all stock options granted using the Black-Scholes option pricing model. 87,500 and 35,000 options were issued during the six months ended November 30, 2014 and November 30, 2013, respectively.

At November 30, 2014, the Company had a total of 332,500 outstanding stock options (205,002 vested and exercisable and 127,498 non-vested) with a weighted average exercise price of $3.68. The Company estimates that $130,999 will be recorded as additional stock-based compensation expense for all options that were outstanding as of November 30, 2014, but which were not yet vested.

Outstanding Options			Exercisable Options	
Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (yrs)	Number of Shares	Weighted Average Exercise Price
35,000	$ 2.53	8.9	11,668	$ 2.53
112,500	2.84	9.5	8,334	2.90
130,000	3.65	6.5	130,000	3.65
5,000	5.80	0.9	5,000	5.80
50,000	6.25	3.5	50,000	6.25
332,500	3.68	7.2	205,002	4.24

Options granted, exercised, and forfeited or canceled under the Company s stock option plan during the three and six months ended November 30, 2014 are summarized as follows:

	Three Months Ended November 30, 2014		Six Months Ended November 30, 2014	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding - beginning of period	245,000	$ 3.99	281,666	$ 3.77
Options granted	87,500	2.82	87,500	2.82
Options exercised	0	0	0	0
Options forfeited/canceled	0	0	(36,666)	2.30
Options outstanding - end of period	332,500	3.68	332,500	3.68

Note 4:

EPS RECONCILIATION

	Three Months Ended November 30,		Six Months Ended November 30,	
	2014	2013	2014	2013
Weighted average shares (basic)	2,995,910	2,990,910	2,995,910	2,990,910
Effect of dilutive stock options	0	0	0	0
Weighted average shares (diluted)	2,995,910	2,990,910	2,995,910	2,990,910

Basic earnings (loss) per share is computed using the weighted average number of common shares outstanding. Diluted earnings (loss) per share is computed using the weighted average number of common shares outstanding, adjusted for

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dilutive incremental shares attributed to outstanding options to purchase common stock. Common stock equivalents for stock options are computed using the treasury stock method. In periods in which a net loss is incurred, no common stock equivalents are included since they are antidilutive and as such all stock options outstanding are excluded from the computation of diluted net loss in those periods.

Note 5:

INCOME TAXES

The Company accounts for income taxes using the asset and liability method. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of assets and liabilities. Deferred tax assets are reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

Each year the Company files income tax returns in the various national, state and local income taxing jurisdictions in which it operates. These tax returns are subject to examination and possible challenge by the taxing authorities. Positions challenged by the taxing authorities may be settled or appealed by the Company. As a result, there is an uncertainty in income taxes recognized in the Company s financial statements in accordance with ASC Topic 740. The Company applies this guidance by defining criteria that an individual income tax position must meet for any part of the benefit of that position to be recognized in an enterprise s financial statements and provides guidance on measurement, de-recognition, classification, accounting for interest and penalties, accounting in interim periods, disclosure, and transition.

Other long-term liabilities related to tax contingencies were $0 as of both November 30, 2014 and May 31, 2014. Interest and penalties associated with uncertain tax positions are recognized as components of the Provision for income taxes. The liability for payment of interest and penalties was $0 as of November 30, 2014 and May 31, 2014.

Several tax years are subject to examination by major tax jurisdictions. In the United States, federal tax years for Fiscal 2011 and after are subject to examination. In the United Kingdom, tax years for Fiscal 2012 and after are subject to examination. In Canada, tax years for Fiscal 2005 and after are subject to examination.

Effective Tax Rate

The effective tax rate on consolidated net loss was 35.7% for the six months ended November 30, 2014. The effective tax rate on consolidated net income (loss) differs from the federal statutory tax rate primarily due to the amount of income from foreign jurisdictions, changes in the deferred tax valuation allowance and certain expenses not being deductible for income tax reporting purposes. Management believes the effective tax rate for Fiscal 2015 will be approximately 2.3% due to the items noted above.

Note 6:

SEGMENTS OF BUSINESS

The Company has two reportable business segments: dynamic balancing and process control systems for the machine tool industry (Balancer) and laser-based test and measurement systems and ultrasonic measurement products (Measurement). The Company operates in three principal geographic markets: North America, Europe and Asia.

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Segment Information

	Three Months Ended November 30, 2014		Three Months Ended November 30, 2013	
	Balancer	Measurement	Balancer	Measurement
Gross sales	$ 2,250,911	$ 1,204,966	$ 2,233,836	$ 1,182,514
Intercompany sales	(328,062)	23,689	(267,914)	(5,384)
Net sales	$ 1,922,849	$ 1,228,655	$ 1,965,922	$ 1,177,130
Operating loss	$ (37,759)	$ (33,042)	$ (127,360)	$ (23,914)
Depreciation expense	$ 24,471	$ 10,983	$ 37,848	$ 15,218
Amortization expense	$ 0	$ 29,808	$ 0	$ 33,658
Capital expenditures	$ 4,477	$ 0	$ 1,093	$ 0

	Six Months Ended November 30, 2014		Six Months Ended November 30, 2013	
	Balancer	Measurement	Balancer	Measurement
Gross sales	$ 4,267,346	$ 2,409,436	$ 4,402,408	$ 2,193,330
Intercompany sales	(504,327)	28,337	(534,670)	(18,569)
Net sales	$ 3,763,019	$ 2,437,773	$ 3,867,738	$ 2,174,761
Operating income (loss)	$ (109,583)	$ 91,881	$ (240,376)	$ (58,242)
Depreciation expense	$ 54,272	$ 22,211	$ 76,147	$ 31,840
Amortization expense	$ 0	$ 63,467	$ 0	$ 67,317
Capital expenditures	$ 13,050	$ 0	$ 1,436	$ 0

Geographic Information-Net Sales by Geographic Area

	Three Months Ended November 30, 2014	Three Months Ended November 30, 2013	Six Months Ended November 30, 2014	Six Months Ended November 30, 2013
North America	$ 1,800,419	$ 1,811,421	$ 3,819,073	$ 3,692,273
Europe	411,314	566,210	626,550	875,341
Asia	863,045	695,396	1,627,482	1,373,181
Other markets	76,726	70,025	127,687	101,704

Total net sales	$ 3,151,504	$ 3,143,052	$ 6,200,792	$ 6,042,499

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	Three Months Ended November 30, 2014		2013	
	United States	Europe	United States	Europe
Operating income (loss)	$ (102,407)	$ 31,606	$ (127,149)	$ (24,125)
Depreciation expense	$ 35,454	$ 0	$ 53,066	$ 0
Amortization expense	$ 29,808	$ 0	$ 33,658	$ 0
Capital expenditures	$ 4,477	$ 0	$ 1,093	$ 0

	Six Months Ended November 30, 2014		2013	
	United States	Europe	United States	Europe
Operating income (loss)	$ (36,467)	$ 18,765	$ (256,741)	$ (41,877)
Depreciation expense	$ 76,483	$ 0	$ 107,987	$ 0
Amortization expense	$ 63,467	$ 0	$ 67,317	$ 0
Capital expenditures	$ 13,050	$ 0	$ 1,436	$ 0

Note Europe is defined as the European subsidiary, Schmitt Europe, Ltd.

Segment and Geographic Assets

	November 30, 2014	May 31, 2014
Segment assets to total assets		
Balancer	$ 4,975,158	$ 4,863,423
Measurement	4,477,755	4,449,064
Corporate assets	1,709,207	1,511,904
Total assets	$ 11,162,120	$ 10,824,391
Geographic assets to long-lived assets		
United States	$ 1,128,160	$ 1,191,591
Europe	0	0
Total long-lived assets	$ 1,128,160	$ 1,191,591
Geographic assets to total assets		
United States	$ 10,126,585	$ 10,090,242
Europe	1,035,535	734,149

Total assets	$ 11,162,120	$ 10,824,391

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This Quarterly Report filed with the SEC on Form 10-Q (the Report), including Management s Discussion and Analysis of Financial Condition and Results of Operations in this Item 2, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 regarding future events and the future results of Schmitt Industries, Inc. and its consolidated subsidiaries (the Company) that are based on management s current expectations, estimates, projections and assumptions about the Company s business. Words such as expects, anticipates, intends, plans, believes, sees, estimates and variations of such words and similar expressions are to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors, including, but not limited to, those discussed in the Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Report as well as those discussed from time to time in the Company s other Securities and Exchange Commission filings and reports. In addition, such statements could be affected by general industry and market conditions. Such forward-looking statements speak only as of the date of this Report or, in the case of any document incorporated by reference, the date of that document, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Report. If we update or correct one or more forward-looking statements, investors and others should not conclude that we will make additional updates or corrections with respect to other forward-looking statements.

RESULTS OF OPERATIONS

Overview

Schmitt Industries, Inc. designs, manufactures and markets computer-controlled vibration detection, balancing and process control equipment (the Balancer segment) to the worldwide machine tool industry and through its wholly owned subsidiary, Schmitt Measurement Systems, Inc., designs, manufactures and markets precision laser-based surface measurement products, laser-based distance measurement products and ultrasonic measurement systems (the Measurement segment) for a variety of industrial applications worldwide. The Company sells and markets its products in Europe through its wholly owned subsidiary, Schmitt Europe Ltd. (SEL), located in the United Kingdom. The Company is organized into two operating segments: the Balancer segment and the Measurement segment. The accompanying unaudited financial information should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended May 31, 2014.

SBS, SMS, Acuity, Xact , Lasercheck and AccuProfile are registered trademarks owned by the Company.

For the three months ended November 30, 2014, total sales increased $8,452, or 0.3%, to $3,151,504 from $3,143,052 in the three months ended November 30, 2013. For the six months ended November 30, 2014, total sales increased $158,293, or 2.6%, to $6,200,792 from $6,042,499 in the six months ended November 30, 2013.

Balancer segment sales focus throughout the world on end-users, rebuilders and original equipment manufacturers of grinding machines with the target geographic markets in North America, South America, Asia and Europe. Balancer segment sales decreased $43,073, or 2.2%, to $1,922,849 for the three months ended November 30, 2014 compared to $1,965,922 for the three months ended November 30, 2013, primarily due to softer sales in North America, offset in part by increased sales into Asia and Europe. Balancer segment sales decreased $104,719, or 2.7%, to $3,763,019 for the six months ended November 30, 2014 compared to $3,867,738 for the six months ended November 30, 2013. The decrease in worldwide balancer sales for the six month period ended November 30, 2014 is attributed to softer sales in our North American market, offset in part by increased sales in Asia.

The Measurement segment product line consists of laser-based light-scatter, distance measurement and dimensional sizing products and ultrasonic-based remote tank monitoring products for propane and diesel tanks. Total Measurement segment sales increased $51,525, or 4.4%, to $1,228,655 for the three months ended November 30, 2014 compared to $1,177,130 for the three months ended November 30, 2013, primarily due to an increase in revenues associated with the sales of remote tank monitoring products and related monitoring services, offset in part by a decrease in sales of our laser-based light-scatter surface measurement products. Total Measurement segment sales increased $263,012, or 12.1%, to $2,437,773 for the six months ended November 30, 2014 compared to $2,174,761 for the six months ended November 30, 2013. The increase in worldwide measurement system sales for the six month period ended November 30, 2014 is primarily due to the delivery and acceptance of one of our CASI® (Complete Angle Scatter Instrument) Scatterometer during the first quarter of Fiscal 2015 and an increase in revenues associated with the sales of remote tank monitoring products and related monitoring services.

Operating expenses increased $5,837, or 0.4%, to $1,624,979 for the three months ended November 30, 2014 from $1,619,142 for the three months ended November 30, 2013. Operating expenses decreased $62,161, or 2.0%, to $3,035,447 for the six months ended November 30, 2014 from $3,097,608 for the six months ended November 30, 2013. General, administration and sales expenses decreased $6,718, or 0.4%, to $1,500,328 for the three months ended November 30, 2014 from $1,507,046 for the same period in the prior year. General, administration and sales expenses decreased $20,396, or 0.7%, to $2,838,352 for the six months ended November 30, 2014 from $2,858,748 for the same period in the prior year. Research and development expenses increased $12,555, or 11.2%, to $124,651 for the three months ended November 30, 2014 from $112,096 for the three months ended November 30, 2013. Research and development expenses decreased $41,765, or 17.5%, to $197,095 for the six months ended November 30, 2014 from $238,860 for the six months ended November 30, 2013.

Net loss was $69,840, or $(0.02) per fully diluted share, for the three months ended November 30, 2014 as compared to net loss of $163,201, or $(0.05) per fully diluted share, for the three months ended November 30, 2013. Net loss was $18,057, or $(0.01) per fully diluted share, for the six months ended November 30, 2014 as compared to net loss of $309,760, or $(0.10) per fully diluted share, for the six months ended November 30, 2013.

Critical Accounting Policies

There were no material changes in our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended May 31, 2014.

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Discussion of Operating Results

	Three Months Ended November 30,			
	2014		2013	
Balancer sales	$ 1,922,849	61.0%	$ 1,965,922	62.5%
Measurement sales	1,228,655	39.0%	1,177,130	37.5%
Total sales	3,151,504	100.0%	3,143,052	100.0%
Cost of sales	1,597,326	50.7%	1,675,184	53.3%
Gross profit	1,554,178	49.3%	1,467,868	46.7%
Operating expenses:				
General, administration and sales	1,500,328	47.6%	1,507,046	47.9%
Research and development	124,651	4.0%	112,096	3.6%
Total operating expenses	1,624,979	51.6%	1,619,142	51.5%
Operating loss	(70,801)	-2.2%	(151,274)	-4.8%
Other income (loss)	3,336	0.1%	(9,546)	-0.3%
Loss before income taxes	(67,465)	-2.1%	(160,820)	-5.1%
Provision for income taxes	2,375	0.1%	2,381	0.1%
Net loss	$ (69,840)	-2.2%	$ (163,201)	-5.2%

	Six Months Ended November 30,			
	2014		2013	
Balancer sales	$ 3,763,019	60.7%	$ 3,867,738	64.0%
Measurement sales	2,437,773	39.3%	2,174,761	36.0%
Total sales	6,200,792	100.0%	6,042,499	100.0%
Cost of sales	3,183,047	51.3%	3,243,509	53.7%
Gross profit	3,017,745	48.7%	2,798,990	46.3%
Operating expenses:				
General, administration and sales	2,838,352	45.8%	2,858,748	47.3%
Research and development	197,095	3.2%	238,860	4.0%
Total operating expenses	3,035,447	49.0%	3,097,608	51.3%
Operating loss	(17,702)	-0.3%	(298,618)	-4.9%
Other income (loss)	4,397	0.1%	(6,093)	-0.1%

Loss before income taxes		(13,305)	-0.2%		(304,711)	-5.0%
Provision for income taxes		4,752	0.1%		5,049	0.1%
Net loss	$	(18,057)	-0.3%	$	(309,760)	-5.1%

Sales Sales in the Balancer segment decreased $43,073, or 2.2%, to $1,922,849 for the three months ended November 30, 2014 compared to $1,965,922 for the three months ended November 30, 2013. This decrease is primarily attributed to softer sales in our North America market, offset in part by increased sales in Asia and Europe. Sales in North America decreased $182,279, or 17.9%, for the three months ended November 30, 2014 as compared to the three months ended November 30, 2013. Asia sales increased $98,889, or 17.2%, in the three months ended November 30, 2014 compared to the same period in the prior year. European sales increased $68,928, or 21.4%, in the second quarter of Fiscal 2015 compared to the second quarter of Fiscal 2014. Sales in other regions of the world decreased $28,611, or 53.6%, in the second quarter of Fiscal 2015 as compared to the same quarter in the prior year.

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Sales in the Balancer segment decreased $104,719, or 2.7%, to $3,763,019 for the six months ended November 30, 2014 compared to $3,867,738 for the six months ended November 30, 2013. This decrease is primarily due to lower unit sales in North America, offset in part by increased sales into the Asia market. Sales in North America decreased $288,481, or 14.3%, for the six months ended November 30, 2014 as compared to the six months ended November 30, 2013. Asia sales increased $152,487, or 12.4%, in the six months ended November 30, 2014 compared to the same period in the prior year. European sales increased $33,792, or 6.1%, in the first half of Fiscal 2015 compared to the first half of Fiscal 2014. Sales in other regions of the world decreased $2,517, or 3.7%, in the six months ended November 30, 2014 as compared to the same period in the prior year. The levels of demand for our Balancer products in any of the geographic markets cannot be forecasted with any certainty given the recent volatility in the global economy and the historical volatility experienced in these markets.

Sales in the Measurement segment increased $51,525, or 4.4%, to $1,228,655 in the three months ended November 30, 2014 compared to $1,177,130 in the three months ended November 30, 2013. Sales of remote tank monitoring products and revenues from monitoring services increased $127,296, or 57.6%, to $348,454 during the second quarter of Fiscal 2015 as compared to $221,158 for the same period in the prior year. Sales of light-scatter laser-based surface measurement products in the three months ended November 30, 2014 decreased $95,821, or 31.4%, as compared to the same period in the prior year primarily due to the delivery and acceptance of one of our CASI® products during the quarter ended November 30, 2013. Sales of laser-based distance measurement and dimensional sizing products were relatively flat as compared to the same period in the prior year, increasing $18,242, or 3.1%.

Sales in the Measurement segment increased $263,012, or 12.1%, to $2,437,773 in the six months ended November 30, 2014 compared to $2,174,761 in the six months ended November 30, 2013. Sales of remote tank monitoring products and revenues from monitoring services increased $142,061, or 26.7%, to $673,745 during the first half of Fiscal 2014 as compared to $531,684 for the same period in the prior year. Sales of light-scatter laser-based surface measurement products in the six months ended November 30, 2014 increased $265,249, or 74.1%, as compared to the same period in the prior year. These increases were offset by the decrease in sales of laser-based distance measurement and dimensional sizing products in the amount of $143,646, or 12.2%, for the six months ended November 30, 2014 as compared to the same period in the prior year. Given the recent volatility in these markets, future sales of laser-based measurement products cannot be forecasted with any certainty.

Gross margin Gross margin for the three months ended November 30, 2014 increased to 49.3% as compared to 46.7% for the three months ended November 30, 2013. Gross margin for the six months ended November 30, 2014 increased to 48.7% as compared to 46.3% for the six months ended November 30, 2013. The overall increase in gross margin in both the three and six months periods ended November 30, 2014 as compared to the three and six month periods in the first half of the prior fiscal year is primarily influenced by shifts in the product sales mix involving our five product lines.

Operating expenses Operating expenses increased $5,837, or 0.4%, to $1,624,979 for the three months ended November 30, 2014 as compared to $1,619,142 for the three months ended November 30, 2013. General, administrative and selling expenses decreased $6,718, or 0.4%, for the three months ended November 30, 2014 as compared to the same period in the prior year primarily due to increases in trade show expenses offset by reductions in professional fees and general office and utilities costs. Research and development expenses increased $12,555, or 11.2%, as compared to the same period in the prior year based on several new development projects within our existing product lines occurring during the latter part of the second quarter of Fiscal 2015. Operating expenses decreased $62,161, or 2.0%, to $3,035,447 for the six months ended November 30, 2014 as compared to $3,097,608 for the six months ended November 30, 2013. General, administrative and selling expenses decreased $20,396, or 0.7%, for the six months ended November 30, 2014 as compared to the same period in the prior year primarily due to increases in trade show expenses offset by reductions in professional fees and general office and utilities costs. Research and development expenses decreased $41,765, or 17.5%, as compared to the same period in the prior year due to the completion of development projects within our existing product lines in the first quarter offset by an increase in costs associated with several new development projects occurring during the latter part of the second quarter of Fiscal 2015.

Other income Other income consists of interest income (expense), foreign currency exchange gain (loss) and other income (expense). Interest income (expense), net was $1,743 and $(5,120) for the three months ended November 30, 2014 and 2013, respectively and $(1,886) and $(6,803) for the six months ended November 30, 2014 and 2013, respectively. Foreign currency exchange gains (losses) were $1,578 and $(3,979) for the three months ended November 30, 2014 and 2013, respectively and $6,255 and $1,157 for the six months ended November 30, 2014 and 2013, respectively. The shifts in the foreign currency exchange are related to fluctuations of foreign currencies against the U.S. dollar during the current period.

Income taxes The Company s effective tax rate on consolidated net loss was 35.7% for the six months ended November 30, 2014. The effective tax rate on consolidated net income (loss) differs from the federal statutory tax rate primarily due to the amount of income from foreign jurisdictions, changes in the deferred tax valuation allowance and certain expenses not being deductible for income tax reporting purposes. Management believes the effective tax rate for Fiscal 2015 will be approximately 2.3% due to the items noted above

Net loss Net loss was $69,840, or $(0.02) per diluted share, for the three months ended November 30, 2014 as compared to a net loss of $163,201, or $(0.05) per diluted share, for the three months ended November 30, 2013. Net loss for the second quarter of Fiscal 2015 decreased as compared to the same period in the prior year primarily due to shifts in product mix with increased sales of higher margin products. Net loss was $18,057, or $(0.01) per diluted share, for the six months ended November 30, 2014 as compared to a net loss of $309,760, or $(0.10) per diluted share, for the same period in the prior year. Net loss for the first half of Fiscal 2015 decreased as compared to the same period in the prior year primarily due to shifts in product mix with increased sales of higher margin products along with decreases in certain operating expenses.

LIQUIDITY AND CAPITAL RESOURCES

The Company s working capital increased to $7,534,477 as of November 30, 2014 as compared to $7,478,073 as of May 31, 2014. Cash and cash equivalents increased $196,916 to $1,707,481 as of August 31, 2014 from $1,510,565 as of May 31, 2014.

Cash provided by operating activities totaled $255,013 for the six months ended November 30, 2014 as compared to cash used in operating activities of $203,411 for the six months ended November 30, 2013. The increase in cash provided by operating activities was primarily impacted by the $18,057 in net loss for the first half of Fiscal 2015 as compared to $309,760 of net loss in the first half of Fiscal 2014. Changes in accounts receivable and accounts payable and other accrued liabilities also impacted the total cash provided/used and the changes are the result of timing of receipts and payments.

At November 30, 2014, the Company had accounts receivable of $2,540,227 as compared to $2,235,194 at May 31, 2014. The increase in accounts receivable of $305,033 was due to timing of receipts. Inventories increased $3,657 to $4,793,479 as of November 30, 2014 compared to $4,789,822 at May 31, 2014, which is due in part to a planned inventory purchase within the Xact® product line and targeted increases in our SBS product line, offset by decreases in inventories in our other product lines. At November 30, 2014, total current liabilities increased $408,222 to $1,619,306 as compared to $1,211,084 at May 31, 2014. The increase in accounts payable and other accrued expenses is primarily due to the timing of payments to our vendors and an increase in accrued commissions.

During the six months ended November 30, 2014, net cash used by investing activities was $13,050, which was for building improvements necessary for the installation of manufacturing equipment being leased by the Company and purchase of office furniture.

The Company had a $2 million bank line of credit secured by U.S. accounts receivable, inventories, general intangibles and a depository account. The line of credit was subject to certain covenant requirements if draws on the line were executed. Interest was payable at the bank s prime rate or LIBOR plus 2.0%. The term on the line of credit expired on September 1, 2014, and the Company chose not to renew the line. The outstanding balance on the line of credit was $0 at May 31, 2014.

We believe that our existing cash and cash equivalents combined with the cash we anticipate to generate from operating activities and financing available from other sources will be sufficient to meet our cash requirements for the foreseeable future. We do not have any significant commitments nor are we aware of any significant events or conditions that are likely to have a material impact on our liquidity or capital resources.

Risk Factors

Please refer to the risk factors disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended May 31, 2014 for a listing of factors that could cause actual results or events to differ materially from those contained in any forward-looking statements made by or on behalf of the Company.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes from the information previously reported under Item 7A of our Annual Report on Form 10-K for the fiscal year ended May 31, 2014.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of November 30, 2014, the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer and the Company s Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures, as such term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the Exchange Act). Based on the evaluation, the Company s Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this Report, the Company s disclosure controls and procedures are effective to ensure that information required to be disclosed in the Company s Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to the Company s management, including the Company s Chief Executive Officer and the Company s Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives, and management necessarily is required to use its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Control Over Financial Reporting

There has been no change in the Company s internal control over financial reporting that occurred during the Company s fiscal quarter ended November 30, 2014 that has materially affected, or is reasonably likely to materially affect, such internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 6. Exhibits

Exhibit	Description
3.1	Second Restated Articles of Incorporation of Schmitt Industries, Inc. (the Company). Incorporated by reference to Exhibit 3(i) to the Company s Annual Report on Form 10-K for the fiscal year ended May 31, 1998.
3.2	Second Restated Bylaws of the Company. Incorporated by reference to Exhibit 3(ii) to the Company s Annual Report on Form 10-K for the fiscal year ended May 31, 1998.
4.1	See Exhibits 3.1 and 3.2 for provisions of the Articles of Incorporation and Bylaws defining the rights of security holders.
31.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.

SIGNATURES

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

SCHMITT INDUSTRIES, INC.
(Registrant)

Date: January 13, 2015

/s/ Ann M. Ferguson
Ann M. Ferguson, Chief Financial Officer and Treasurer