SCHMITT INDUSTRIES INC
Form 10-Q
January 11, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: November 30, 2017

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

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 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 No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

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

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

The number of shares of each class of common stock outstanding as of December 31, 2017

Common stock, no par value	3,994,545

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SCHMITT INDUSTRIES, INC.

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	November 30, 2017	May 31, 2017
ASSETS		
Current assets		
Cash and cash equivalents	$ 586,986	$ 867,607
Accounts receivable, net	2,150,655	2,344,373
Inventories	4,792,085	4,204,723
Prepaid expenses	105,436	115,756
Income taxes receivable	714	7,310
	7,635,876	7,539,769
Property and equipment, net	819,219	865,224
Other assets		
Intangible assets, net	549,059	601,351
TOTAL ASSETS	$ 9,004,154	$ 9,006,344
LIABILITIES & STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 1,201,098	$ 1,101,066
Accrued commissions	266,727	300,234
Accrued payroll liabilities	229,584	360,239
Other accrued liabilities	318,929	267,418
Total current liabilities	2,016,338	2,028,957
Stockholders equity		
Common stock, no par value, 20,000,000 shares authorized, 2,995,910 shares issued and outstanding at November 30, 2017 and May 31, 2017	10,690,126	10,649,287
Accumulated other comprehensive loss	(427,132)	(427,572)
Accumulated deficit	(3,275,178)	(3,244,328)
Total stockholders equity	6,987,816	6,977,387

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	9,004,154	$	9,006,344

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

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SCHMITT INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

FOR THE THREE AND SIX MONTHS ENDED NOVEMBER 30, 2017 AND 2016

(UNAUDITED)

	Three Months Ended November 30,		Six Months Ended November 30,	
	2017	2016	2017	2016
Net sales	$ 3,770,880	$ 2,655,561	$ 6,854,528	$ 5,548,093
Cost of sales	2,044,898	1,623,151	3,729,027	3,139,934
Gross profit	1,725,982	1,032,410	3,125,501	2,408,159
Operating expenses:				
General, administration and sales	1,524,443	1,324,675	2,992,787	2,737,344
Research and development	100,760	60,277	177,217	139,124
Total operating expenses	1,625,203	1,384,952	3,170,004	2,876,468
Operating income (loss)	100,779	(352,542)	(44,503)	(468,309)
Other income (expense), net	9,078	(23,578)	26,621	(25,411)
Income (loss) before income taxes	109,857	(376,120)	(17,882)	(493,720)
Provision for income taxes	6,609	6,350	12,968	14,379
Net income (loss)	$ 103,248	$ (382,470)	$ (30,850)	$ (508,099)
Net income (loss) per common share:				
Basic	$ 0.03	$ (0.13)	$ (0.01)	$ (0.17)
Weighted average number of common shares, basic	2,995,910	2,995,910	2,995,910	2,995,910
Diluted	$ 0.03	$ (0.13)	$ (0.01)	$ (0.17)
Weighted average number of common shares, diluted	3,024,099	2,995,910	2,995,910	2,995,910
Comprehensive income (loss)				
Net income (loss)	$ 103,248	$ (382,470)	$ (30,850)	$ (508,099)
Foreign currency translation adjustment	15,164	(19,185)	440	(63,702)
Total comprehensive income (loss)	$ 118,412	$ (401,655)	$ (30,410)	$ (571,801)

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, 2017 AND 2016

(UNAUDITED)

	Six Months Ended November 30,	
	2017	2016
Cash flows relating to operating activities		
Net loss	$ (30,850)	$ (508,099)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	104,645	110,437
(Gain) loss on disposal of property and equipment	619	(16,899)
Stock based compensation	40,839	15,468
(Increase) decrease in:		
Accounts receivable	218,163	238,684
Inventories	(569,393)	206,624
Prepaid expenses	11,286	(16,747)
Income taxes receivable	6,596	6,553
Increase (decrease) in:		
Accounts payable	97,824	(382,255)
Accrued liabilities and customer deposits	(114,766)	(87,440)
Net cash used in operating activities	(235,037)	(433,674)
Cash flows relating to investing activities		
Purchases of property and equipment	(8,467)	(44,587)
Proceeds from the sale of property and equipment	1,500	20,085
Net cash used in investing activities	(6,967)	(24,502)
Effect of foreign exchange translation on cash	(38,617)	12,697
Decrease in cash and cash equivalents	(280,621)	(445,479)
Cash and cash equivalents, beginning of period	867,607	988,686
Cash and cash equivalents, end of period	$ 586,986	$ 543,207
Supplemental disclosure of cash flow information		
Cash paid during the period for income taxes	$ 6,322	$ 7,826
Cash paid during the period for interest	$ 785	$ 1,726

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, 2017

(UNAUDITED)

	Shares	Amount	Accumulated other comprehensive loss	Accumulated deficit	Total
Balance, May 31, 2017	2,995,910	$ 10,649,287	$ (427,572)	$ (3,244,328)	$ 6,977,387
Stock-based compensation	0	40,839	0	0	40,839
Net loss	0	0	0	(30,850)	(30,850)
Other comprehensive loss	0	0	440	0	440
Balance, November 30, 2017	2,995,910	$ 10,690,126	$ (427,132)	$ (3,275,178)	$ 6,987,816

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, 2017 and its results of operations and its cash flows for the periods presented. The consolidated balance sheet at May 31, 2017 has been derived from the Annual Report on Form 10-K for the fiscal year ended May 31, 2017. 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, 2017. 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, 2018.

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. The Company estimates customer product returns based on historical return patterns and reduces sales and cost of sales accordingly.

Financial Instruments

The carrying value of all other financial instruments potentially subject to valuation risk (principally consisting of cash and cash equivalents, accounts receivable and accounts payable) 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 $72,326 and $32,572 as of November 30, 2017 and May 31, 2017, respectively.

Inventories

Inventories are valued at the lower of cost or net realizable value 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, 2017 and May 31, 2017, inventories consisted of:

	November 30, 2017	May 31, 2017
Raw materials	$ 2,050,894	$ 1,773,368
Work-in-process	1,116,650	937,878
Finished goods	1,624,541	1,493,477
	$ 4,792,085	$ 4,204,723

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Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation and amortization. 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, 2017 and May 31, 2017, property and equipment consisted of:

	November 30, 2017	May 31, 2017
Land	$ 299,000	$ 299,000
Buildings and improvements	1,814,524	1,814,524
Furniture, fixtures and equipment	1,252,844	1,246,346
Vehicles	44,704	44,704
	3,411,072	3,404,574
Less accumulated depreciation	(2,591,853)	(2,539,350)
	$ 819,219	$ 865,224

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 affects any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 by one year. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted as of the date of the original effective date, for interim and annual reporting periods beginning after December 15, 2016. The Company is currently evaluating the provisions of ASU 2014-09 and the potential impact on its consolidated financial statements. To date, the Company has examined its current revenue streams and does not believe that the adoption of this guidance will have a material impact on revenue recognition patterns as compared to revenue recognition under existing guidance, as the Company expects that revenues generated will continue to be recognized upon the shipment of products to customers. The Company will continue to evaluate the impacts of the provisions of ASU 2014-09 through the date of adoption to ensure that preliminary conclusions continue to remain accurate. Additionally, the Company is assessing ASU 2014-09 s impact on its consolidated financial statement disclosures and currently expects to adopt ASU 2014-09 on June 1, 2018 using the modified retrospective method.

Subsequent Event

On December 20, 2017, the Company completed its Subscription Rights Offering (the Rights Offering) in which 998,635 common shares were issued, resulting in gross proceeds to the Company of $2,496,588. Pursuant to the Rights Offering, the Company issued one right for each common share to shareholders of record as of November 27, 2017. Holders of the rights were entitled to purchase common shares by submitting three rights and $2.50 for each share to be purchased. The new shares were issued on December 27, 2017.

NOTE 2:

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:

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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 0.

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.

To determine stock-based compensation expense recognized for those options granted during the six months ended November 30, 2017 and 2016, the Company has computed the value of all stock options granted using the Black-Scholes option pricing model. No options were issued during the six months ended November 30, 2017 and 2016.

At November 30, 2017, the Company had a total of 360,000 outstanding stock options (218,330 vested and exercisable and 141,670 non-vested) with a weighted average exercise price of $2.28. The Company estimates that $50,171 will be recorded as additional stock-based compensation expense over a weighted-average period of 1.0 years for all options that were outstanding as of November 30, 2017, 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
212,500	$ 1.70	9.4	70,830	$ 1.70
15,000	2.53	5.8	15,000	2.53
77,500	2.85	6.4	77,500	2.85
55,000	3.65	3.5	55,000	3.65
360,000	2.28	7.7	218,330	2.66

Options granted, exercised, and forfeited or canceled under the Company s stock option plan during the three and six months ended November 30, 2017 are summarized as follows:

	Three Months Ended November 30, 2017		Six Months Ended November 30, 2017	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding beginning of period	360,000	$ 2.28	360,000	$ 2.28
Options granted	0	0	0	0
Options exercised	0	0	0	0
Options forfeited/canceled	0	0	0	0
Options outstanding end of period	360,000	2.28	360,000	2.28

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NOTE 3:

EPS RECONCILIATION

	Three Months Ended November 30,		Six Months Ended November 30,	
	2017	2016	2017	2016
Weighted average shares (basic)	2,995,910	2,995,910	2,995,910	2,995,910
Effect of dilutive stock options	28,189	0	0	0
Weighted average shares (diluted)	3,024,099	2,995,910	2,995,910	2,995,910

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 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 4:

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. Management continues to review the level of the valuation allowance on a quarterly basis. There can be no assurance that the Company s future operations will produce sufficient earnings to that the deferred tax asset can be fully utilized. The Company currently maintains a full valuation allowance against net deferred tax assets.

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, 2017 and May 31, 2017. 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, 2017 and May 31, 2017.

Several tax years are subject to examination by major tax jurisdictions. In the United States, federal tax years ended May 31, 2014 and after are subject to examination. In the United Kingdom, tax years ended May 31, 2012 and after are subject to examination. In Canada, tax years ended May 31, 2014 and after are subject to examination.

Effective Tax Rate

The effective tax rate on consolidated net loss was 72.2% for the six months ended November 30, 2017. The effective tax rate on consolidated net loss differs from the federal statutory tax rate primarily due to 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 2018 will be approximately 11.4% due to the items noted above.

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NOTE 5:

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.

Segment Information

	Three Months Ended November 30,			
	2017		2016	
	Balancer	Measurement	Balancer	Measurement
Gross sales	$ 2,639,442	$ 1,540,034	$ 1,612,330	$ 1,261,863
Intercompany sales	(408,596)	0	(214,664)	(3,968)
Net sales	$ 2,230,846	$ 1,540,034	$ 1,397,666	$ 1,257,895
Operating income (loss)	$ (88,986)	$ 189,765	$ (273,715)	$ (78,827)
Depreciation expense	$ 16,388	$ 9,361	$ 19,018	$ 9,390
Amortization expense	$ 0	$ 26,146	$ 0	$ 27,882
Capital expenditures	$ 889	$ 0	$ 0	$ 0

	Six Months Ended November 30,			
	2017		2016	
	Balancer	Measurement	Balancer	Measurement
Gross sales	$ 5,084,928	$ 2,553,285	$ 3,440,380	$ 2,605,917
Intercompany sales	(783,685)	0	(481,838)	(16,366)
Net sales	$ 4,301,243	$ 2,553,285	$ 2,958,542	$ 2,589,551
Operating income (loss)	$ (300,766)	$ 256,263	$ (486,926)	$ 18,617
Depreciation expense	$ 33,370	$ 18,983	$ 35,805	$ 18,867
Amortization expense	$ 0	$ 52,292	$ 0	$ 55,765
Capital expenditures	$ 8,467	$ 0	$ 44,587	$ 0

Geographic Information **Net Sales by Geographic Area**

	Three Months Ended November 30,		Six Months Ended November 30,	
	2017	2016	2017	2016
North America	$ 2,484,977	$ 1,788,495	$ 4,276,078	$ 3,742,857
Europe	457,036	327,494	974,899	650,906
Asia	795,483	449,859	1,544,905	948,479
Other markets	33,384	89,713	58,646	205,851
Total net sales	$ 3,770,880	$ 2,655,561	$ 6,854,528	$ 5,548,093

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	Three Months Ended November 30, 2017		2016	
	United States	Europe	United States	Europe
Operating income (loss)	$ 31,655	69,124	$ (311,302)	(41,240)
Depreciation expense	$ 25,749	$ 0	$ 28,408	$ 0
Amortization expense	$ 26,146	$ 0	$ 27,882	$ 0
Capital expenditures	$ 889	$ 0	$ 0	$ 0

	Six Months Ended November 30, 2017		2016	
	United States	Europe	United States	Europe
Operating income (loss)	$ (183,810)	139,307	$ (405,467)	(62,842)
Depreciation expense	$ 52,353	$ 0	$ 54,672	$ 0
Amortization expense	$ 52,292	$ 0	$ 55,765	$ 0
Capital expenditures	$ 8,467	$ 0	$ 44,587	$ 0

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

Segment and Geographic Assets

	November 30, 2017	May 31, 2017
Segment assets to total assets		
Balancer	$ 5,302,684	$ 4,791,100
Measurement	3,113,770	3,340,327
Corporate assets	587,700	874,917
Total assets	$ 9,004,154	$ 9,006,344
Geographic assets to long-lived assets		
United States	$ 819,219	$ 865,224
Europe	0	0
Total long-lived assets	$ 819,219	$ 865,224
Geographic assets to total assets		
United States	$ 7,833,228	$ 8,149,507
Europe	1,170,926	856,837
Total assets	$ 9,004,154	$ 9,006,344

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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, 2017.

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

For the three months ended November 30, 2017, total sales increased $1,115,319, or 42.0%, to $3,770,880 from $2,655,561 in the three months ended November 30, 2016. For the six months ended November 30, 2017, total sales increased $1,306,435, or 23.5%, to $6,854,528 from $5,548,093 in the six months ended November 30, 2016.

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, Asia and Europe. Balancer segment sales increased $833,180, or 59.6%, to $2,230,846 for the three months ended November 30, 2017 compared to $1,397,666 for the three months ended November 30, 2016. Balancer segment sales increased $1,342,701, or 45.4%, to $4,301,243 for the six months ended November 30, 2017 compared to $2,958,542 for the six months ended November 30, 2016.

The Measurement segment product lines consist of laser and white light distance measurement and dimensional sizing products and ultrasonic-based remote tank monitoring products for propane, diesel and other tank-based liquids. Total Measurement segment sales increased $282,139, or 22.4%, to $1,540,034 for the three months ended November 30, 2017 compared to $1,257,895 for the three months ended November 30, 2016. Total Measurement segment sales decreased $36,266, or 1.4%, to $2,553,285 for the six months ended November 30, 2017 compared to $2,589,551 for the six months ended November 30, 2016.

Operating expenses increased $240,251, or 17.3%, to $1,625,203 for the three months ended November 30, 2017 from $1,384,952 for the three months ended November 30, 2016. General, administration and sales expenses increased $199,768, or 15.1%, to $1,524,443 for the three months ended November 30, 2017 from $1,324,675 for the same period in the prior year. Operating expenses increased $293,536, or 10.2%, to $3,170,004 for the six months ended November 30, 2017 from $2,876,468 for the six months ended November 30, 2016. General, administration and sales expenses increased $255,443, or 9.3%, to $2,992,787 for the six months ended November 30, 2017 from $2,737,344 for the same period in the prior year.

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Net income was $103,248, or $0.03 per fully diluted share, for the three months ended November 30, 2017 as compared to net loss of $382,470, or $(0.13) per fully diluted share, for the three months ended November 30, 2016. For the six months ended November 30, 2017, net loss was $30,850, or $(0.01) per fully diluted share, as compared to net loss of $508,099, or $(0.17) per fully diluted share, for the six months ended November 30, 2016.

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, 2017.

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Discussion of Operating Results

	Three Months Ended			
	November 30, 2017		November 30, 2016	
Balancer sales	$ 2,230,846	59.2%	$ 1,397,666	52.6%
Measurement sales	1,540,034	40.8%	1,257,895	47.4%
Total sales	3,770,880	100.0%	2,655,561	100.0%
Cost of sales	2,044,898	54.2%	1,623,151	61.1%
Gross profit	1,725,982	45.8%	1,032,410	38.9%
Operating expenses:				
General, administration and sales	1,524,443	40.4%	1,324,675	49.9%
Research and development	100,760	2.7%	60,277	2.3%
Total operating expenses	1,625,203	43.1%	1,384,952	52.2%
Operating income (loss)	100,779	2.7%	(352,542)	-13.3%
Other Income (loss), net	9,078	0.2%	(23,578)	-0.9%
Income (loss) before income taxes	109,857	2.9%	(376,120)	-14.2%
Provision for income taxes	6,609	0.2%	6,350	0.2%
Net income (loss)	$ 103,248	2.7%	$ (382,470)	-14.4%

	Six Months Ended			
	November 30, 2017		November 30, 2016	
Balancer sales	$ 4,301,243	62.8%	$ 2,958,542	53.3%
Measurement sales	2,553,285	37.2%	2,589,551	46.7%
Total sales	6,854,528	100.0%	5,548,093	100.0%
Cost of sales	3,729,027	54.4%	3,139,934	56.6%
Gross profit	3,125,501	45.6%	2,408,159	43.4%
Operating expenses:				
General, administration and sales	2,992,787	43.7%	2,737,344	49.3%
Research and development	177,217	2.6%	139,124	2.5%
Total operating expenses	3,170,004	46.2%	2,876,468	51.8%
Operating loss	(44,503)	-0.6%	(468,309)	-8.4%
Other income (loss), net	26,621	0.4%	(25,411)	-0.5%

Loss before income taxes	(17,882)	-0.3%	(493,720)	-8.9%
Provision for income taxes	12,968	0.2%	14,379	0.3%
Net loss	$ (30,850)	-0.5%	$ (508,099)	-9.2%

Sales Sales in the Balancer segment increased $833,180, or 59.6%, to $2,230,846 for the three months ended November 30, 2017 as compared to $1,397,666 for the three months ended November 30, 2016. This increase is attributed to stronger sales across our North America, Asia and Europe markets. Sales in North America increased $342,633, or 47.6%, sales in Asia increased $286,179, or 122.3%, and sales in Europe increased $208,701, or 49.5%, for the three months ended November 30, 2017 as compared to the same period in the prior year. Sales in other regions of the world decreased $4,333 for the three months ended November 30, 2017 as compared to the same quarter in the prior year.

Sales in the Balancer segment increased $1,342,701, or 45.4%, to $4,301,243 for the six months ended November 30, 2017 as compared to $2,958,542 for the six months ended November 30, 2016. This increase is attributed to stronger sales across our North America, Asia and Europe markets. Sales in North America increased $389,667, or 25.6%, sales in Asia increased $489,234, or 102.1%, and sales in Europe increased $513,440, or 59.4%, for the six months ended November 30, 2017 as compared to the same period in the prior year. Sales in other regions of the world decreased $49,640 for the six months ended November 30, 2017 as compared to the same quarter in the prior year.

Sales in the Measurement segment increased $282,139, or 22.4%, to $1,540,034 for the three months ended November 30, 2017 compared to $1,257,895 for the three months ended November 30, 2016. Sales of our Acuity laser and white light sensor distance measurement and dimensional-sizing products increased $349,637, or 71.8%, for the three months ended November 30, 2017 as compared to the same quarter in the prior year. While sales of Xact products decreased $58,714, or 14.6%, during the quarter ended November 30, 2017 as compared to the same period in the prior year, revenues derived from the Xact monitoring services increased $32,539, or 12.6%, for the quarter ended November 30, 2017 as compared to the same quarter in the prior year. Sales of our Lasercheck and SMS products decreased $41,323, or 37.9%, during the second quarter of fiscal 2018 as compared to the same period in the prior year. During fiscal 2017, the Company made the decision to no longer focus on and eventually phase out the SMS and Lasercheck product lines.

Sales in the Measurement segment decreased $36,266, or 1.4%, to $2,553,285 for the six months ended November 30, 2017 compared to $2,589,551 for the six months ended November 30, 2016. Sales of our Acuity laser-based distance measurement and dimensional-sizing products increased $301,300, or 26.9%, in the six months ended November 30, 2017 as compared to the six months ended November 30, 2016. While sales of Xact products decreased $286,060, or 37.4%, during the six months ended November 30, 2017 as compared to the same period in the prior year, revenues derived from the Xact monitoring services increased $80,113, or 16.1%, during the first half of fiscal 2018 as compared to the same period in the prior year. Sales of our Lasercheck and SMS products decreased $131,619, or 63.6%, for the six months ended November 30, 2017 as compared to the same period in the prior year. During fiscal 2017, the Company made the decision to no longer focus on and eventually phase out the SMS and Lasercheck product lines.

Gross margin Gross margin for the three months ended November 30, 2017 increased to 45.8% as compared to 38.9% for the three months ended November 30, 2016. Gross margin for the six months ended November 30, 2017 increased to 45.6% as compared to 43.4% for the six months ended November 30, 2016. The fluctuations in gross margin in the three and six month periods ended November 30, 2017 as compared to the same three and six month periods in the prior fiscal year are influenced by shifts in the product sales mix from our five product lines in Fiscal 2017 to our three product lines in Fiscal 2018.

Operating expenses Operating expenses increased $240,251, or 17.3%, to $1,625,203 for the three months ended November 30, 2017 as compared to $1,384,952 for the three months ended November 30, 2016. General, administrative and selling expenses increased $199,768, or 15.1%, for the three months ended November 30, 2016 as compared to the same period in the prior year. These increases are primarily due to increases in professional expenses, personnel expenses and sales commissions, offset by reductions in marketing and trade show expense and other sales-related travel and entertainment expense.

Operating expenses increased $293,536, or 10.2%, to $3,170,004 for the six months ended November 30, 2017 as compared to $2,876,468 for the six months ended November 30, 2016. General, administrative and selling expenses increased $255,443, or 9.3%, for the six months ended November 30, 2016 as compared to the same period in the prior year. These increases are primarily due to increases in professional and personnel expense, offset by reductions in marketing and trade show expense and other sales-related travel and entertainment expense.

Other income Other income consists of interest income (expense), foreign currency exchange gain (loss) and other income (expense). Interest income (expense), net was $(65) and $26 for the three months ended November 30, 2017 and 2016, respectively. Foreign currency exchange gains (losses) were $9,747 and $(23,007) for the three months ended November 30, 2017 and 2016, respectively. The shifts in the foreign currency exchange are related to fluctuations of foreign currencies against the U.S. dollar during the current period. Other income (expense) was $(604) for the second quarter of fiscal 2017 as compared to $(597) for the same period in the prior year.

Other income consists of interest income (expense), foreign currency exchange gain (loss) and other income (expense). Interest income (expense), net was $32 and $(330) for the six months ended November 30, 2017 and 2016, respectively. Foreign currency exchange gains (losses) were $27,188 and $(42,006) for the six months ended November 30, 2017 and 2016, respectively. The shifts in the foreign currency exchange are related to fluctuations of foreign currencies against the U.S. dollar during the current period. Other income (expense) was $(599) for the first six months of fiscal 2018 as compared to $16,925 for the same period in the prior year.

Income taxes The Company s effective tax rate on consolidated net loss was 72.2% for the six months ended November 30, 2017. The effective tax rate on consolidated net loss differs from the federal statutory tax rate primarily due to 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 2018 will be approximately 11.4% due to the items noted above.

Net income (loss) Net income was $103,248, or $0.03 per fully diluted share, for the three months ended November 30, 2017 as compared to net loss of $382,470, or $(0.13) per fully diluted share, for the three months ended November 30, 2016. For the six months ended November 30, 2017, net loss was $30,850, or $(0.01) per fully diluted share, as compared to net loss of $508,099, or $(0.17) per fully diluted share, for the six months ended November 30, 2016.

LIQUIDITY AND CAPITAL RESOURCES

The Company s working capital increased to $5,619,538 as of November 30, 2017 as compared to $5,510,812 as of May 31, 2017. Cash and cash equivalents decreased $280,621 to $586,986 as of November 30, 2017 from $867,607 as of May 31, 2017.

Cash used in operating activities totaled $235,037 for the six months ended November 30, 2017 as compared to cash used in operating activities of $433,674 for the six months ended November 30, 2016. The change in cash used in operating activities was impacted, in part, by the difference in net loss of $30,850 for the six months ended November 30, 2017 as compared to net loss of $508,099 for the same period in the prior year. Changes in accounts receivable, inventories, accounts payable and other accrued liabilities also impacted the total cash used in operating activities, with the result of the changes directly related to the timing of receipts and payments and the targeted increases in inventory levels within our SBS and Acuity product lines.

At November 30, 2017, the Company had accounts receivable of $2,150,655 as compared to $2,344,373 at May 31, 2017. The decrease in accounts receivable of $193,718 was due to timing of receipts. Inventories increased $587,362 to $4,792,085 as of November 30, 2017 as compared to $4,204,723 at May 31, 2017, which is due primarily to the targeted increases in inventory levels within our SBS and Acuity product lines. At November 30, 2017, total current liabilities decreased $12,619 to $2,016,338 as compared to $2,028,957 at May 31, 2017. The decrease in current liabilities is primarily due to the timing of payments to our vendors and Company personnel and the decrease in accrued commissions.

On December 20, 2017, the Company completed its Subscription Rights Offering (the Rights Offering) in which 998,635 common shares were issued, resulting in gross proceeds to the Company of $2,496,588. Pursuant to the Rights Offering, the Company issued one right for each common share to shareholders of record as of November 27, 2017. Holders of the rights were entitled to purchase common shares by submitting three rights and $2.50 for each share to be purchased. The new shares were issued on December 27, 2017.

We believe that our existing cash and cash equivalents combined with the cash we anticipate to generate from operating activities and the Rights Offering discussed above 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, 2017 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.

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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, 2017.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of November 30, 2017, 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, 2017 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. [Form 10-K for the fiscal year ended May 31, 1998, Exhibit 3(i)].
3.2	Second Restated Bylaws of Schmitt Industries, Inc. [Form 10-K for the fiscal year ended May 31, 1998, Exhibit 3(ii)].
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.

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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 11, 2018

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

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