SCHMITT INDUSTRIES INC
Form 10-Q
April 13, 2016
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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: February 29, 2016

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	**(IRS Employer**
incorporation or organization)	**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 March 31, 2016

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)

	February 29, 2016	May 31, 2015
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,135,365	$ 1,795,654
Accounts receivable, net	1,984,806	2,660,426
Inventories	4,774,992	4,557,567
Prepaid expenses	131,375	153,970
Income taxes receivable	1,343	1,029
	8,027,881	9,168,646
Property and equipment, net	995,780	1,110,878
Other assets		
Intangible assets, net	740,764	824,411
TOTAL ASSETS	$ 9,764,425	$ 11,103,935
LIABILITIES & STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 642,648	$ 834,002
Accrued commissions	284,836	284,944
Accrued payroll liabilities	129,217	140,872
Other accrued liabilities	275,335	355,513
Total current liabilities	1,332,036	1,615,331
Stockholders equity		
Common stock, no par value, 20,000,000 shares authorized, 2,995,910 shares issued and outstanding at February 29, 2016 and May 31, 2015	10,559,644	10,511,324
Accumulated other comprehensive loss	(421,725)	(366,945)
Accumulated deficit	(1,705,530)	(655,775)

Total stockholders equity		8,432,389	9,488,604
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	9,764,425	$ 11,103,935

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 NINE MONTHS ENDED FEBRUARY 29, 2016 AND FEBRUARY 28, 2015

(UNAUDITED)

	Three Months Ended		Nine Months Ended	
	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
Net sales	$ 2,528,465	$ 3,010,618	$ 8,706,618	$ 9,211,410
Cost of sales	1,465,104	1,660,256	4,924,355	4,843,303
Gross profit	1,063,361	1,350,362	3,782,263	4,368,107
Operating expenses:				
General, administration and sales	1,405,632	1,405,140	4,525,149	4,243,492
Research and development	68,023	95,730	227,435	292,825
Total operating expenses	1,473,655	1,500,870	4,752,584	4,536,317
Operating loss	(410,294)	(150,508)	(970,321)	(168,210)
Other loss, net	(34,117)	(15,578)	(59,128)	(11,181)
Loss before income taxes	(444,411)	(166,086)	(1,029,449)	(179,391)
Provision for income taxes	6,495	2,285	20,306	7,037
Net loss	$ (450,906)	$ (168,371)	$ (1,049,755)	$ (186,428)
Net loss per common share:				
Basic	$ (0.15)	$ (0.06)	$ (0.35)	$ (0.06)
Weighted average number of common shares, basic	2,995,910	2,995,910	2,995,910	2,995,910
Diluted	$ (0.15)	$ (0.06)	$ (0.35)	$ (0.06)
Weighted average number of common shares, diluted	2,995,910	2,995,910	2,995,910	2,995,910

Comprehensive loss				
Net loss	$ (450,906)	$ (168,371)	$ (1,049,755)	$ (186,428)
Foreign currency translation adjustment	(39,107)	(36,239)	(54,780)	(115,148)
Total comprehensive loss	$ (490,013)	$ (204,610)	$ (1,104,535)	$ (301,576)

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 NINE MONTHS ENDED FEBRUARY 29, 2016 AND FEBRUARY 28, 2015

(UNAUDITED)

	Nine Months Ended	
	February 29, 2016	February 28, 2015
Cash flows relating to operating activities		
Net loss	$ (1,049,755)	$ (186,428)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	187,614	201,982
Gain on sale of property and equipment	(299)	0
Stock based compensation	48,320	49,713
(Increase) decrease in:		
Accounts receivable	647,856	(244,823)
Inventories	(260,379)	50,305
Prepaid expenses	20,707	(15,192)
Income taxes receivable	(314)	(190)
Increase (decrease) in:		
Accounts payable	(185,115)	95,133
Accrued liabilities	(87,380)	285,074
Income taxes payable	0	(210)
Net cash provided by (used in) operating activities	(678,745)	235,364
Cash flows relating to investing activities		
Proceeds from sale of property and equipment	14,950	0
Purchases of property and equipment	(3,520)	(18,933)
Net cash provided by (used in) investing activities	11,430	(18,933)
Effect of foreign exchange translation on cash	7,026	(74,432)
Increase (decrease) in cash and cash equivalents	(660,289)	141,999
Cash and cash equivalents, beginning of period	1,795,654	1,510,565
Cash and cash equivalents, end of period	$ 1,135,365	$ 1,652,564
Supplemental disclosure of cash flow information		

Cash paid during the period for income taxes	$	20,620	$	7,427
Cash paid during the period for interest	$	2,025	$	2,709

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 NINE MONTHS ENDED FEBRUARY 29, 2016

(UNAUDITED)

	Shares	Amount	Accumulated other comprehensive loss	Accumulated deficit	Total
Balance, May 31, 2015	2,995,910	$ 10,511,324	$ (366,945)	$ (655,775)	$ 9,488,604
Stock-based compensation	0	48,320	0	0	48,320
Net loss	0	0	0	(1,049,755)	(1,049,755)
Other comprehensive loss	0	0	(54,780)	0	(54,780)
Balance, February 29, 2016	2,995,910	$ 10,559,644	$ (421,725)	$ (1,705,530)	$ 8,432,389

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 February 29, 2016 and its results of operations and its cash flows for the periods presented. The consolidated balance sheet at May 31, 2015 has been derived from the Annual Report on Form 10-K for the fiscal year ended May 31, 2015. 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, 2015. 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, 2016.

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 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 $14,774 and $56,370 as of February 29, 2016 and

May 31, 2015, 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 February 29, 2016 and May 31, 2015, inventories consisted of:

	February 29, 2016	May 31, 2015
Raw materials	$ 2,058,153	$ 1,845,037
Work-in-process	1,031,223	836,346
Finished goods	1,685,616	1,876,184
	$ 4,774,992	$ 4,557,567

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Property and Equipment

Property and equipment are stated at cost less 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 February 29, 2016 and May 31, 2015, property and equipment consisted of:

	February 29, 2016	May 31, 2015
Land	$ 299,000	$ 299,000
Buildings and improvements	1,814,524	1,814,524
Furniture, fixtures and equipment	1,343,612	1,381,691
Vehicles	96,587	96,587
	3,553,723	3,591,802
Less accumulated depreciation	(2,557,943)	(2,480,924)
	$ 995,780	$ 1,110,878

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:

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 nine months ended February 29, 2016 and February 28, 2015, the Company has computed the value of all stock options granted using the Black-Scholes option pricing model. No options were granted during the nine months ended February 29, 2016. 87,500 options were granted during the nine months ended February 28, 2015.

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At February 29, 2016, the Company had a total of 327,500 outstanding stock options (249,168 vested and exercisable and 78,332 non-vested) with a weighted average exercise price of $3.65. The Company estimates that $36,578 will be recorded as additional stock-based compensation expense over a weighted-average period of 1.2 years for all options that were outstanding as of February 29, 2016, 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	7.6	23,333	$ 2.53
112,500	2.84	8.3	45,835	2.85
130,000	3.65	5.3	130,000	3.65
50,000	6.25	2.3	50,000	6.25
327,500	3.65	6.1	249,168	3.92

Options granted, exercised, and forfeited or canceled under the Company s stock option plan during the three and nine months ended February 29, 2016 are summarized as follows:

	Three Months Ended February 29, 2016		Nine Months Ended February 29, 2016	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding - beginning of period	332,500	$ 3.68	332,500	$ 3.68
Options granted	0	0	0	0
Options exercised	0	0	0	0
Options forfeited/canceled	(5,000)	5.80	(5,000)	5.80
Options outstanding - end of period	327,500	3.65	327,500	3.65

Note 3:

EPS RECONCILIATION

	Three Months Ended		Nine Months Ended	
	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
	2,995,910	2,995,910	2,995,910	2,995,910

Weighted average shares (basic)				
Effect of dilutive stock options	0	0	0	0
Weighted average shares (diluted)	2,995,910	2,995,910	2,995,910	2,995,910

Basic loss per share is computed using the weighted average number of common shares outstanding. Diluted 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.

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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.

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 February 29, 2016 and May 31, 2015. 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 February 29, 2016 and May 31, 2015.

Several tax years are subject to examination by major tax jurisdictions. In the United States, federal tax years for Fiscal 2012 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 2.0% for the nine months ended February 29, 2016. The effective tax rate on consolidated net 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 2016 will be approximately 2.3% due to the items noted above.

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.

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Segment Information

	Three Months Ended			
	February 29, 2016		February 28, 2015	
	Balancer	Measurement	Balancer	Measurement
Gross sales	$ 1,670,316	$ 1,248,769	$ 2,269,691	$ 1,108,449
Intercompany sales	(389,844)	(776)	(366,209)	(1,313)
Net sales	$ 1,280,472	$ 1,247,993	$ 1,903,482	$ 1,107,136
Operating loss	$ (348,631)	$ (61,663)	$ (127,375)	$ (23,133)
Depreciation expense	$ 23,057	$ 9,477	$ 23,271	$ 10,879
Amortization expense	$ 0	$ 27,882	$ 0	$ 27,882
Capital expenditures	$ 3,520	$ 0	$ 5,883	$ 0

	Nine Months Ended			
	February 29, 2016		February 28, 2015	
	Balancer	Measurement	Balancer	Measurement
Gross sales	$ 6,089,441	$ 3,622,681	$ 6,537,038	$ 3,517,884
Intercompany sales	(1,000,745)	(4,759)	(870,537)	27,025
Net sales	$ 5,088,696	$ 3,617,922	$ 5,666,501	$ 3,544,909
Operating income (loss)	$ (684,196)	$ (286,125)	$ (237,357)	$ 69,147
Depreciation expense	$ 74,103	$ 29,864	$ 77,543	$ 33,090
Amortization expense	$ 0	$ 83,647	$ 0	$ 91,349
Capital expenditures	$ 3,520	$ 0	$ 18,933	$ 0

Geographic Information **Net Sales by Geographic Area**

	Three Months Ended	Nine Months Ended

	February 29, 2016	February 28, 2015	February 29, 2016	February 28, 2015
North America	$ 1,776,511	$ 1,894,564	$ 5,944,433	$ 5,713,638
Europe	238,553	226,011	923,275	852,561
Asia	467,508	807,875	1,688,064	2,435,357
Other markets	45,893	82,168	150,846	209,854
Total net sales	$ 2,528,465	$ 3,010,618	$ 8,706,618	$ 9,211,410

	Three Months Ended			
	February 29, 2016		February 28, 2015	
	United States	Europe	United States	Europe
Operating loss	$ (336,999)	$ (73,295)	$ (115,502)	$ (35,006)
Depreciation expense	$ 32,534	$ 0	$ 34,150	$ 0
Amortization expense	$ 27,882	$ 0	$ 27,882	$ 0
Capital expenditures	$ 3,520	$ 0	$ 5,883	$ 0

	Nine Months Ended			
	February 29, 2016		February 28, 2015	
	United States	Europe	United States	Europe
Operating loss	$ (836,741)	$ (133,580)	$ (151,969)	$ (16,241)
Depreciation expense	$ 103,967	$ 0	$ 110,633	$ 0
Amortization expense	$ 83,647	$ 0	$ 91,349	$ 0
Capital expenditures	$ 3,520	$ 0	$ 18,933	$ 0

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

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Segment and Geographic Assets

	February 29, 2016	May 31, 2015
Segment assets to total assets		
Balancer	$ 4,689,503	$ 5,059,567
Measurement	3,938,214	4,247,684
Corporate assets	1,136,708	1,796,684
Total assets	$ 9,764,425	$ 11,103,935
Geographic assets to long-lived assets		
United States	$ 995,780	$ 1,110,878
Europe	0	0
Total long-lived assets	$ 995,780	$ 1,110,878
Geographic assets to total assets		
United States	$ 8,712,243	$ 10,107,523
Europe	1,052,182	996,412
Total assets	$ 9,764,425	$ 11,103,935

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, 2015.

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

For the three months ended February 29, 2016, total sales decreased $482,153, or 16.0%, to $2,528,465 from $3,010,618 in the three months ended February 28, 2015. For the nine months ended February 29, 2016, total sales decreased $504,792, or 5.5%, to $8,706,618 from $9,211,410 in the nine months ended February 28, 2015.

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 decreased $623,010, or 32.7%, to $1,280,472 for the three months ended February 29, 2016 compared to $1,903,482 for the three months ended February 28, 2015, primarily attributed to a significant decline in sales into China and North America for the quarter. Balancer segment sales decreased $577,805, or 10.2%, to $5,088,696 for the nine months ended February 29, 2016 compared to $5,666,501 for the nine months ended February 28, 2015. The decrease in worldwide balancer sales for the nine month period ended February 29, 2016 is primarily attributed to a significant decline in sales into China and decreased sales into other parts of Asia and Europe.

The Measurement segment product line consists of SMS® and Lasercheck® laser-based surface microroughness measurement system, Acuity® laser-based distance measurement and dimensional sizing laser sensors, and Xact® ultrasonic-based remote tank monitoring products. Total Measurement segment sales increased $140,857, or 12.7%, to $1,247,993 for the three months ended February 29, 2016 compared to $1,107,136 for the three months ended February 28, 2015. The increase is primarily due to increased sales in our Acuity product line. Total Measurement segment sales increased $73,013, or 2.1%, to $3,617,922 for the nine months ended February 29, 2016 compared to $3,544,909 for the nine months ended February 28, 2015, due to greater sales in the Acuity and Xact product lines, offset by lower sales in our SMS product line which included a CASI sale in the nine months ended February 28, 2015 but did not include a CASI sale in the current fiscal year.

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Operating expenses decreased $27,215, or 1.8%, to $1,473,655 for the three months ended February 29, 2016 from $1,500,870 for the three months ended February 28, 2015. Operating expenses increased $216,267, or 4.8%, to $4,752,584 for the nine months ended February 29, 2016 from $4,536,317 for the nine months ended February 28, 2015. General, administration and sales expenses increased $492 to $1,405,632 for the three months ended February 29, 2016 from $1,405,140 for the same period in the prior year. General, administration and sales expenses increased $281,657, or 6.6%, to $4,525,149 for the nine months ended February 29, 2016 from $4,243,492 for the same period in the prior year.

Net loss was $450,906, or $(0.15) per fully diluted share, for the three months ended February 29, 2016 as compared to net loss of $168,371, or $(0.06) per fully diluted share, for the three months ended February 28, 2015. Net loss was $1,049,755, or $(0.35) per fully diluted share, for the nine months ended February 29, 2016 as compared to net loss of $186,428, or $(0.06) per fully diluted share, for the nine months ended February 28, 2015.

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, 2015.

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Discussion of Operating Results

	Three Months Ended			
	February 29, 2016		February 28, 2015	
Balancer sales	$ 1,280,472	50.6%	$ 1,903,482	63.2%
Measurement sales	1,247,993	49.4%	1,107,136	36.8%
Total sales	2,528,465	100.0%	3,010,618	100.0%
Cost of sales	1,465,104	57.9%	1,660,256	55.1%
Gross profit	1,063,361	42.1%	1,350,362	44.9%
Operating expenses:				
General, administration and sales	1,405,632	55.6%	1,405,140	46.7%
Research and development	68,023	2.7%	95,730	3.2%
Total operating expenses	1,473,655	58.3%	1,500,870	49.9%
Operating loss	(410,294)	-16.2%	(150,508)	-5.0%
Other loss, net	(34,117)	-1.3%	(15,578)	-0.5%
Loss before income taxes	(444,411)	-17.6%	(166,086)	-5.5%
Provision for income taxes	6,495	0.3%	2,285	0.1%
Net loss	$ (450,906)	-17.8%	$ (168,371)	-5.6%

	Nine Months Ended			
	February 29, 2016		February 28, 2015	
Balancer sales	$ 5,088,696	58.4%	$ 5,666,501	61.5%
Measurement sales	3,617,922	41.6%	3,544,909	38.5%
Total sales	8,706,618	100.0%	9,211,410	100.0%
Cost of sales	4,924,355	56.6%	4,843,303	52.6%
Gross profit	3,782,263	43.4%	4,368,107	47.4%
Operating expenses:				
General, administration and sales	4,525,149	52.0%	4,243,492	46.1%
Research and development	227,435	2.6%	292,825	3.2%
Total operating expenses	4,752,584	54.6%	4,536,317	49.2%

Operating loss	(970,321)	-11.1%	(168,210)	-1.8%
Other loss, net	(59,128)	-0.7%	(11,181)	-0.1%
Loss before income taxes	(1,029,449)	-11.8%	(179,391)	-1.9%
Provision for income taxes	20,306	0.2%	7,037	0.1%
Net loss	$ (1,049,755)	-12.1%	$ (186,428)	-2.0%

Sales Sales in the Balancer segment decreased $623,010, or 32.7%, to $1,280,472 for the three months ended February 29, 2016 compared to $1,903,482 for the three months ended February 28, 2015. The decrease is primarily attributed due to a significant decline in sales into China and North America for the quarter. Sales in North America decreased $289,990, or 32.0%, for the three months ended February 29, 2016 as compared to the three months ended February 28, 2015. China sales decreased $236,787, or 60.2%, for the three months ended February 29, 2016 as compared to the three months ended February 28, 2015. Other Asia sales decreased $104,495, or 29.9%, in the three months ended February 29, 2016 compared to the same period in the prior year. Sales in other regions of the world decreased $37,767, or 54.1%, in the three months ended February 29, 2016 as compared to the same period in the prior year. These decreases were slightly offset by European sales which increased $46,029, or 25.1%, in the third quarter of Fiscal 2016 compared to the third quarter of Fiscal 2015.

Sales in the Balancer segment decreased $577,805, or 10.2%, to $5,088,696 for the nine months ended February 29, 2016 compared to $5,666,501 for the nine months ended February 28, 2015. The decrease in worldwide balancer sales for the nine month period ended February 29, 2016 is primarily attributed to a significant decline in sales into China and decreased sales into other parts of Asia and Europe. China sales decreased $470,673, or 37.9%, for the nine months ended February 29, 2016 as compared to the nine months ended February 28, 2015. Other Asia sales decreased $79,384, or 9.0%, in the nine months ended February 29, 2016 compared to the same period in the prior year. European sales decreased $11,543, or 1.5%, in the first three quarters of Fiscal 2016 compared to the first three quarter of Fiscal 2015. Sales in other regions of the world decreased $63,558, or 47.2%, in the nine months ended February 29, 2016 as compared to the same period in the prior year. Sales in North America increased $47,353, or 1.8%, for the nine months ended February 29, 2016 as compared to the nine months ended February 28, 2015. 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 $140,857, or 12.7%, to $1,247,993 in the three months ended February 29, 2016 compared to $1,107,136 in the three months ended February 28, 2015. Sales of Acuity laser-based distance measurement and dimensional sizing products increased in the amount of $133,594, or 30.6%, for the three months ended February 29, 2016 as compared to the same period in the prior year. Sales of SMS light-scatter laser-based surface measurement products in the three months ended February 29, 2016 increased $53,857, or 87.2%, as compared to the same period in the prior year. Sales of Xact remote tank monitoring products and revenues from monitoring services also posted an increase of $11,037, or 2.2%, for the third quarter of Fiscal 2016 as compared to the same period in the prior year. These increases were offset in part by decreases in sales of our Lasercheck products which decreased $57,631, or 55.0%, for the three months ended February 29, 2016 as compared to the same period in the prior year.

Sales in the Measurement segment increased $73,013, or 2.1%, to $3,617,922 in the nine months ended February 29, 2016 compared to $3,544,909 in the nine months ended February 28, 2015. Sales of Acuity laser-based distance measurement and dimensional sizing products increased $412,449, or 28.0%, for the nine months ended February 29, 2016 as compared to the same period in the prior year. In addition, sales of Xact remote tank monitoring products and revenues from monitoring services increased $64,631, or 5.5%, during the first three quarters of Fiscal 2016 as compared to the same period in the prior year. Sales of SMS and Lasercheck light-scatter laser-based surface measurement products in the nine months ended February 29, 2016 decreased $404,067, or 45.3%, 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 February 29, 2016 decreased to 42.1% as compared to 44.9% for the three months ended February 28, 2015. Gross margin for the nine months ended February 29, 2016 decreased to 43.4% as compared to 47.4% for the nine months ended February 28, 2015. The overall decrease in gross margin in both the three and nine months periods ended February 29, 2016 as compared to the three and nine month ended February 28, 2015 is primarily influenced by shifts in the product sales mix.

Operating expenses Operating expenses decreased $27,215, or 1.8%, to $1,473,655 for the three months ended February 29, 2016 as compared to $1,500,870 for the three months ended February 28, 2015. General, administrative and sales expenses increased $492 for the three months ended February 29, 2016 as compared to the same period in the prior year with increases in sales-related travel expense offset by reductions in sales commissions and professional, legal and accounting expenses. This increase in general, administrative and sales expense was offset by a decrease in spending of $27,707, or 28.9%, for research and development for the quarter ended February 29, 2016 as compared to the same quarter in the prior year.

Operating expenses increased $216,267, or 4.8%, to $4,752,584 for the nine months ended February 29, 2016 as compared to $4,536,317 for the nine months ended February 28, 2015. General, administrative and sales expenses increased $281,657, or 6.6%, for the nine months ended February 29, 2016 as compared to the same period in the prior year due to increases in sales commissions and personnel expense, increases in patent expenses and increases in sales-related travel and general office and utilities costs offset by a reduction in trade show expenses. This increase was offset by a decrease in spending of $65,390, or 22.3%, for research and development for the first three quarters of Fiscal 2016 as compared to the same period in the prior year.

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Other income Other income consists of interest income (expense), foreign currency exchange gain (loss) and other income (expense). Interest income (expense), net was $(260) and $(742) for the three months ended February 29, 2016 and February 28, 2015, respectively and $(1,293) and $(2,628) for the nine months ended February 29, 2016 and February 28, 2015, respectively. Foreign currency exchange gains (losses) were $(33,871) and $(14,848) for the three months ended February 29, 2016 and February 28, 2015, respectively and $(58,166) and $(8,593) for the nine months ended February 29, 2016 and February 28, 2015, respectively. The shifts in the foreign currency exchange are related to fluctuations of foreign currencies against the U.S. dollar during the periods noted.

Income taxes The Company s effective tax rate on consolidated net loss was 2.0% for the nine months ended February 29, 2016. The effective tax rate on consolidated net 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 2016 will be approximately 2.3% due to the items noted above.

Net loss Net loss was $450,906, or $(0.15) per diluted share, for the three months ended February 29, 2016 as compared to a net loss of $168,371, or $(0.06) per diluted share, for the three months ended February 28, 2015. Net loss was $1,049,755, or $(0.35) per diluted share, for the nine months ended February 29, 2016 as compared to a net loss of $186,428, or $(0.06) per diluted share, for the same period in the prior year. Net loss for the three months ended February 29, 2016 is primarily due to decreases in balancer sales and the impact of shifts in product mix towards lower margin products offset by increased sales of products in the measurement segment and decreases in operating expenses. Net loss for the nine months ended February 29, 2016 is primarily due to decreases in balancer sales, the impact of shifts in product mix towards lower margin products and increases in operating expenses offset in part by increases in sales of measurement products.

LIQUIDITY AND CAPITAL RESOURCES

The Company s working capital decreased to $6,695,845 as of February 29, 2016 as compared to $7,553,315 as of May 31, 2015. Cash and cash equivalents decreased $660,289 to $1,135,365 as of February 29, 2016 from $1,795,654 as of May 31, 2015.

Cash used in operating activities totaled $678,745 for the nine months ended February 29, 2016 as compared to cash provided by operating activities of $235,364 for the nine months ended February 28, 2015. The change in cash used in operating activities was primarily impacted by the net loss of $1,049,755 for the nine months ended February 29, 2016 as compared to net loss of $186,428 for the nine months ended February 28, 2015. Changes in accounts receivable, inventories and accounts payable and other accrued liabilities also impacted the total cash provided by/used in operating activities and the changes are the result of timing of receipts and payments.

At February 29, 2016, the Company had accounts receivable of $1,984,806 as compared to $2,660,426 at May 31, 2015. The decrease in accounts receivable of $675,620 was due to timing of receipts. Inventories increased $217,425 to $4,774,992 as of February 29, 2016 compared to $4,557,567 at May 31, 2015, which is due primarily to the timing of purchases across our product lines. At February 29, 2016, total current liabilities decreased $283,295 to $1,332,036 as compared to $1,615,331 at May 31, 2015. The decrease in accounts payable and other accrued expenses is primarily due to the timing of payments to our vendors and a decrease in accrued commissions.

We believe that our existing cash and cash equivalents combined with the cash we anticipate to generate from operating activities 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, 2015 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, 2015.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of February 29, 2016, 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 February 29, 2016 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.

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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: April 13, 2016

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