SCHMITT INDUSTRIES INC
Form 10-K
August 12, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended: May 31, 2015

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 N.W. Nicolai Street

Portland, Oregon 97210

(Address of principal executive offices) (Zip Code)

(503) 227-7908

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock - no par value	**The NASDAQ Stock Market LLC**

Securities registered pursuant to Section 12(g) of the Act:

None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 definitions of large accelerated filer, 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 aggregate market value of the voting stock held by non-affiliates of the registrant as of November 28, 2014, the last business day of the registrant s most recently completed second fiscal quarter, was approximately $5,264,900 based upon the closing price of $3.00 reported for such date on the NASDAQ Capital Market. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 10% of the outstanding shares of Common Stock and shares held by officers and directors of the registrant, have been excluded because such persons may be deemed to be affiliates. This determination is not necessarily conclusive for other purposes.

As of July 31, 2015, the registrant had 2,995,910 outstanding shares of Common Stock.

Documents Incorporated by Reference

Portions of the registrant s definitive Proxy Statement for its 2015 Annual Meeting of Shareholders are incorporated by reference into Part III hereof.

PART I

Item 1. Business

Forward-Looking Statements

This Annual Report on Form 10-K (the Report), including Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7, 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 intended 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 section in Item 1A, Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 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.

Introduction

Schmitt Industries, Inc. (the Company), an Oregon corporation, designs, manufactures and sells high precision test and measurement products for two main business segments: the Balancer segment and the Measurement segment. For the Balancer segment, the Company designs, manufactures and sells computer-controlled vibration detection, balancing and process control systems for the worldwide machine tool industry, particularly for grinding machines. Through its wholly owned subsidiary, Schmitt Measurement Systems, Inc., an Oregon corporation, the Company designs, manufactures and sells laser and white light sensors for distance, dimensional and area measurement for a wide variety of commercial applications, laser-based microroughness measurement products for the semiconductor wafer and hard disk drive industries and for other industrial applications, laser-based surface analysis and measurement products for a variety of scientific applications, and ultrasonic measurement products that accurately measure the fill levels of tanks holding propane, diesel and other tank-based liquids and transmit that data via satellite to a secure web site for display (the Measurement segment). The Company also provides sales and service for Europe and Asia through its wholly owned subsidiary, Schmitt Europe Limited (SEL), located in Coventry, England and through its sales representative office located in Shanghai, China. The Company s corporate office is located at 2765 N.W. Nicolai Street, Portland, Oregon.

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

Balancer Segment

The Company s principal product line for this segment is the Schmitt Dynamic Balance System (SBS), which consists of a vibration sensor, a computer control unit, and a balance head that is placed either externally on the grinding wheel spindle with the use of a spindle mounted adaptor or internally inside the spindle bore. The SB-5500 control panel contains up to four slots for additional circuit boards designed for specific functions, such as manual balancing, balancing using hydro chambers and process monitoring, which involves the detection and

analysis of high frequency noise, known as acoustic emission (AE), generated by the grinding process. SBS products are designed as economical yet highly precise measurement and control devices for permanent or portable installation on grinding machines that can detect and correct imbalance caused by vibration as small as 0.02 microns. Customers can also detect and analyze the AE signal generated during grinding or wheel dressing to help monitor and improve the grinding process. Customers include both end user operators as well as manufacturers of grinding machines worldwide for a wide variety of industries that utilize the grinding process, including the automotive, industrial, aerospace, and medical industries where specifications and operating tolerances on machined parts are increasingly precise.

The SB-5500 is fully automated, eliminating the need to pre-balance parts such as grinding wheels. This reduces machine setup time and ensures a smoother and more efficient grinding process. Operating on a principle of mass compensation for wheel imbalance, the balance head contains two movable eccentric weights, each driven by electric motors through a precision gear train. These weights are repositioned to offset any imbalance in a grinding wheel or other application. Imbalance or vibration is picked up by the vibration sensor that feeds the detected signal to the control unit, which filters the signal by revolutions per minute. The controller then automatically drives the balance head weights in a direction that reduces the amplitude of the vibration signal. The balance cycle is complete when the weights are positioned to achieve the lowest vibration level, as low as 0.02 microns.

The SB-5500 also includes an optional Acoustic Emission Monitoring System (AEMS) control card, which uses proprietary acoustic sensor technology to monitor the AE signal generated on the grinding machine during key events in the grinding process. The AEMS card allows rapid, automatic grinding wheel in-feed, right up to the point of initial contact of the grinding wheel with a new part loaded in the machine. The system can automatically detect the initial contact and very quickly report this event to the machine control, stopping the wheel in-feed without operator intervention. Part crash occurs when a part or fixture is incorrectly loaded into a grinding machine or some abnormal condition occurs. Rapid in-feed of the wheel may then result in a dangerous or expensive crash. The AEMS card allows the grinding machine s operating system (known as a computer numeric control or CNC system) on the machine to monitor the acoustic levels and detect any unexpected contact when it happens. The system then reports that abnormal contact and instructs the CNC program to stop the grinding process, usually within one millisecond.

The SB-5500 also offers two process control cards that fit inside the control panel to provide enhanced control of the grinding process: the ExactControl card and the ExactDress card. The ExactControl process control card offers multi-functional grinding process control capability by detecting and analyzing either the AE signal pattern or the machine power fluctuations and then using one of seven process control strategies to adjust and optimize the grinding process based on that signal data, resulting in improved part quality and reduced operating costs. Software control strategies include ExactDisplay™ (graphically displays the measurement signal), ExactGap (displays and evaluates the measurement signal against a predetermined signal threshold to automatically determine when the grinding wheel touches the work piece and to shorten the time between grinding work pieces), ExactTime™ (displays and evaluates the time interval of a measurement signal that is above a predetermined signal threshold to monitor the minimum or maximum processing time, ExactIntegral™ (displays and evaluates the area under a measurement signal curve to optimize the grinding process for the particular work piece), and ExactDress™ (displays and evaluates the measurement signal and compares it to a standard threshold to optimize the grinding wheel dress process).

The ExactDress control strategy is also available in a separate process control card as part of the AEMS system to automatically monitor and control the grinding wheel dressing process. The AE signal pattern of a wheel dress is displayed and compared to a stored master AE signal pattern and indicates when the dressing process has been successfully completed. Monitoring for AE levels during wheel dressing permits the operator or CNC control to determine if the wheel is being dressed fully across its width, control the aggressiveness of the process and maintain the quality of the dressed wheel to conserve wheel material.

Additional SBS products include the SB-2000 and the AE-1000. The SB-2000 is an easy-to-use, compact manual balancing system offering both one and two plane manual balancing capabilities. The system comes in a

dedicated machine installation version (SB-2000) and a portable version (SB-2000-P). Each version of the system displays up to four digits of resolution for vibration and six digits for RPM readings and supports a spindle speed range of 30 to 100,000 RPM. The portable SB-2000-P version attaches magnetically to any location on the machine for easy setup and use. The AE-1000 is a dedicated AE control platform that reduces air machine grinding time and alerts the operator to potential grinding wheel crash conditions by using proprietary AE detection technology to monitor the high frequency signals generated by the grinding process.

Notable features of the SBS system include its ability to fit almost all grinding machines, ease of installation, compact and modular construction, ability to balance a wheel while on a machine, virtual elimination of wheel vibration, automatic monitoring of balancing, display in a variety of languages and in metric units of measurement, instrument grade calibration, short balance process, measurement of both displacement and/or velocity and minimal operator maintenance. The SB-5500 also offers the capability of fully integrating its operation and output within any grinding machine s CNC operating system by the use of its IVIS (Intelligent Visualization) software.

Benefits of using the SBS system include improved quality of finished parts, elimination of grinding gap time in the grind cycle resulting in increased efficiency and part throughput, ease of product adaptation, monitoring and correction of part crash, minimal downtime, complete and ready installation, elimination of static balancing, longer life of the grinding wheel, diamond dressings and spindle bearings, the ability to balance within 0.02 microns and its adaptability to all types of machines.

Precision grinding is necessary in major manufacturing areas including the automotive industry (gear trains, camshafts, crankshafts, valves), bearings (roller and tapered types), ceramics (precision shaping), electric motors (shafts), pumps (shafts and turbines), aircraft (engine parts such as turbine blades), and general manufacturing. Precision grinding has an established worldwide presence in all industrialized countries and is expanding as a method of material removal and part processing. Within the Company s customer base for the SBS system, there are three major market segments:

Machine Tool Builders These companies design and manufacture a variety of specialty application grinding machines. SBS systems are distributed to markets throughout the world through machine tool original equipment manufacturers (OEMs), who incorporate the SBS system into their products.

Examples of some well-known worldwide machine tool builders who have offered and/or installed the SBS System include Shanghai Machine Tool Works (China), ANCA (Australia), Capco Machinery (U.S.), Drake Manufacturing (U.S.), Ecotech/SMTW (China/U.S.), Erwin Junker (U.S.), Matrix Machine Tool (U.K.), Schleifring Group (Germany, China), Shaanxi Qinchuan Machinery Development Co. (China), Cinetic Landis Grinding (U.S.), Koyo Machinery (U.S./Japan), Micron Machinery Limited (Japan/U.S.), USACH Technologies (U.S.), Tschudin (U.S.) and Weldon Solutions (U.S.). The Company currently sells its products directly to major machine builders throughout the world.

Machine Tool Rebuilders These customers, found in most, if not all, industrialized nations, develop their business by offering to completely update and refurbish older grinding machines. These rebuilders typically tear the old machine apart and install new components, such as the SBS system. The Company currently sells its products directly to major machine rebuilders throughout the world.

Grinding Machine Users These end users become aware of the SBS system through trade shows, trade magazine advertising, distributors, field representatives, referrals and new machine suppliers. The Company s business is conducted worldwide with some better known customers including: Black & Decker, Briggs and Stratton, Schaeffler, Caterpillar, Eaton, Emerson Power Transmission, Cummins Engine, Ford Motor Company, General Electric, General Motors, Ingersoll Rand, Komatsu, Sumitomo Heavy Industries, SKF Bearing Industries, Timken, TRW Automotive Components and Universal Bearing.

For the years ended May 31, 2015, May 31, 2014 and May 31, 2013 (Fiscal 2015, 2014 and 2013), net sales of the Company s balancing products totaled $7,850,236, $7,721,211 and $7,714,122, respectively. Net sales of balancing products accounted for 60%, 64% and 62% of the Company s total sales in Fiscal 2015, 2014 and 2013, respectively. See Note 6 to Consolidated Financial Statements.

Competition

Competitors in the Balancer Segment primarily come from Germany and Italy. These competitors produce electromechanical and water balancers and process control products similar to SBS. The Company s primary competitors are Marposs S.p.A., MPM Micro Prazision Marx GmbH and Balance Systems S.r.l.

Measurement Segment

Within the Measurement Segment, the Company designs, manufactures and sells laser and white light sensors for distance, dimensional and area measurement for a wide variety of commercial applications, laser-based microroughness measurement products for the semiconductor wafer and hard disk drive industries and for other industrial applications, laser-based surface analysis and measurement products for a variety of scientific applications, and ultrasonic measurement products that accurately measure the fill levels of tanks holding propane, diesel and other tank-based liquids and transmit that data via satellite to a secure web site for display.

Laser and White Light Sensors

These products include lasers utilizing both triangulation and time-of-flight methods of measurement, and confocal chromatic white light sensors that are used in a wide range of industrial applications including manufacturing, lumber production, steel casting, glass and paper production, medical imaging, crane control and micron-level part and surface inspection and are sold under the Acuity brand. Presently, there are 12 products offered under the Acuity brand: The AccuRange (AR)1000, AR2000, AR2500 and AR3000 distance measurement sensors, the AR700, AR500 and AR200 series of triangulating laser displacement sensors, the AR CCS Prima and the AR CCS Initial chromatic confocal sensors, the AccuProfile (AP) 400 and AP820 and the Aquity (AQ) 6 2D laser line scanners. The Company designs, manufactures and sells the AR200 and AR700 and distributes the AR500, AR1000, AR2000, AR2500, AR3000, AR CCS Prima, AR CCS Initial, AP400, AP820 and the AQ6, primarily into North America.

The AR1000, AR2000, AR2500 and AR3000 distance measurement lasers utilize pulsed time of flight measurement principles to accurately measure distances of up to 30 meters (up to 300 meters with retro-reflective tape) with the AR1000, up to 100 meters (500 meters with retro-reflective tape) with the AR2000, up to 50 meters (500 meters with retro-reflective tape) with the AR2500 and up to 300 meters (3000 meters with retro-reflective tape) with the AR3000. These products are highly versatile, being able to measure distances both indoors and outdoors. Applications include, but are not limited to, load confirmation, alignment, lumber positioning, crane monitoring, fill level measurement, velocity measurement and laser altimeter.

The AR700 is a triangulation laser displacement sensor that provides superior performance in terms of accuracy, repeatability, and sample speed. The AR700 boasts output speeds up to 9400 Hz and resolutions as a micron. The laser will output 9400 distance readings in a single second. The unit is also very compact, measuring approximately 80% smaller than its predecessor, the AR600. Model variations permit applications up to 50 inches in range. Applications include high speed road profiling, product dimensional or thickness measurement, rubber thickness measurement, lumber or plywood thickness measurement, carton dimensioning and product positioning.

The AR500 is a compact triangulation laser displacement sensor that provides accurate measurements (+/- 0.15% linearity) at high speeds (standard to 9400 Hz, high speed option up to 56K Hz). The same compact enclosure houses models with ranges from 5 to 1000 millimeters. Sensor options include blue laser diodes, faster speeds and cooling jackets. Applications include radiating surfaces and high speed applications such as road texture, ballistics and high speed event monitoring.

The AR200 line is the Company s most compact series of triangulating laser displacement sensors. Five models cover metric measurement ranges from 6 to 100 millimeters. All models boast a 1/500 accuracy rating for measurements within twelve microns. All models are standard with analog, limit switch and serial outputs. The

AR200 sensors, much like the longer-range AR700 sensors, project a beam of visible laser light that creates a spot on the target surface. Reflected light from the surface is viewed from an angle by a line scan camera and the target s distance is computed from the image pixel data. The AR200-6M, -12M, -25M, -50M, and -100M have ranges in millimeters that match their model number. The AR200 displacement sensor cannot be overloaded and measures accurately even when a mirror reflects the entire light beam back to the detector.

The AR CCS Prima white light confocal-chromatic displacement sensor is the most precise measurement system from Acuity. Using a novel optical principle of measuring the reflected light s component wavelengths, these confocal sensors measure distance and position to within nanometers. These compact probes can measure to opaque, shiny or even transparent surfaces. Unlike the other Acuity distance sensors, the Prima Confocal systems are comprised of an optical measurement pen and a separate controller. This controller houses all of the electronics, light source, etc. Only emitted white light and reflected signals are passed between the pen and the controller via a thin fiber-optic transmission cable. The Confocal-Chromatic Sensors (CCS) are offered in a variety of measurement ranges and standoff distances, each with a corresponding resolution. The shortest-range models resolve to 5 nanometers of height change.

The AR CCS Initial confocal sensor is an extremely precise point sensor for measuring displacement and thickness. Each system includes a controller unit, a fiber optic cable, a measuring probe and all necessary cables and software. The CCS Initial measures distance and topography of varied targets, including silicon, polished metals, glass, contoured lenses, polymers, semiconductor masks and natural materials. The technology in the CCS Initial supports nanometer-scale resolutions and the system comes in five different measurement models that range from 0.4 to 12.0 mm.

The AP400 series line sensors are entry-level two-dimensional CMOS digital sensors for industrial surface dimensioning and measurement applications. The scanner quickly and accurately generates low noise 2D profile scans of objects, surface or scenes. The sensor has an onboard processor and memory and comes with AcuityView image analysis software. Typical applications include weld gap tracking and weld bead profiling, positional control of objects and surfaces, tire profiling, wheel profiling, surface profiling, 3D profile generation and dimensional measurement.

The AP820 is a two-dimensional laser line scanner that measures surface height profiles by projecting a beam of visible laser light that creates a line on a targeted surface. The AP820 is a highly accurate sensor for industrial surface dimensional and measurement applications. The scanner quickly and accurately generates low-noise 2D or 3D profile scans of objects, surfaces or scenes. The sensor automatically adjusts laser power and detector exposure to compensate for varying surface conditions. Typical scanner applications include weld gap tracking and weld bead profiling, positional control of objects and surfaces, tire profiling, wheel profiling, surface profiling, 3D profile generation and dimensional measurement.

The new AQ6 laser line sensor offers higher speed and higher resolution, with models from 0.3 megapixels to over 12 megapixels. The AQ6 uses the latest in new high density CMOS camera design with new Gigabit Ethernet communications and the newly released GeniCam high speed vision protocols. This allows the customer to increase the resolution on the target and reduce the amount of sensors needed for larger parts. The new outputs also will allow for a faster and less expensive integration of the sensor into the customer s application. Applications include pipe and tube manufacturers, large laser line applications for flaw detection and high accuracy scans of difficult targets. The AQ6 also lends itself to custom OEM applications with laser lines of over 80 inches in length. Currently there are nine AQ6 models available.

Surface Roughness Measurement Products

These products use a patented technology using laser light scatterometry to perform rapid, accurate, repeatable, non-destructive and non-contact surface measurement tests that quantify surface micro-roughness. The

technology is extremely precise, measuring surface roughness at the molecular (sub-Angstrom) level. Products are sold to manufacturers of hard disk drives, semiconductors, silicon wafers and optical products and industries involved in fabrication processes that require precise and reliable measurements.

Computer hard disk drives require exact manufacturing control and a narrow tolerance band for acceptable roughness, with surface roughness outside that narrow band resulting in a reduction in data density or storage capacity. The Company s technology simultaneously measures disk surface roughness in two directions, radially, when the read/write head is moving to another disk sector, and circumferentially, when the read/write head is processing information on the disk. The two separate roughness levels are required for proper head operation. The Company believes the precise measurement methods provided by its products are not possible through any other cost-effective measurement means.

The Company s product for the disk industry is the TMS (Texture Measurement System) 2000-RC, an accurate non-contact texture measurement system. The product (used on aluminum substrates) is currently used worldwide by most major disk drive manufacturers, providing fast, accurate and repeatable microroughness measurements while quadrupling production throughput when compared to other testing devices. Surface roughness can be measured to levels below 0.5 Angstroms. An Angstrom (Å) is a unit of measure equal to 1 hundred-millionth of a centimeter (the point of a needle is one million Å in diameter).

The Company offers two products devoted to the semiconductor wafer industry: the TMS2000W-RC and TMS3000W-RC. Both products provide fast, accurate, repeatable measurements for manufacturers of silicon wafers, device quality semiconductors and memory devices. This industry demands manufacturing precision to increase performance and capacity and these products help achieve those goals. Silicon wafers are carefully cut and polished to provide the base upon which a computer or memory chip is produced. Therefore, chip manufacturing is extremely dependent on the beginning surface roughness of the wafer. Since all silicon wafers exhibit a microscopic level of surface roughness stemming from production techniques such as chemical deposition, grinding, polishing and etching, some method of measuring surface roughness is required. The Company s wafer measurement products provide a way for customers to quantify and control their manufacturing process. The system provides measurements to less than 0.5 Å.

The Company also offers the Lasercheck line of surface roughness measurement gauges. Lasercheck is a unique laser-based non-contact roughness gauge incorporating patented laser light-scatter technology that can make precise and repeatable surface roughness measurements in the 0.025 to 2 micron (<1.0 to 80 micro inches) range. Lasercheck provides high-speed in-process measurements in a fraction of a second and is optimized for surface measurements of ground, sanded, polished, hone, super-finished and shot-blasted surfaces.

Laser Light-Scatter Surface Measurement Products

The Company s CASI (Complete Angle Scatter Instrument) Scatterometers are sold to companies and institutions involved in scientific research and development. The CASI Scatterometer uses visible, ultraviolet or infrared laser light as a nondestructive probe to measure surface quality, optical performance, smoothness, appearance, defects and contamination on a wide variety of materials. These products are scientific measurement instruments providing customers with molecular-level precision in roughness measurement of optical surfaces, diffuse materials, semiconductor wafers, magnetic storage media and precision-machined surfaces, as well as surfaces affecting the cosmetic appearance of consumer products.

The MicroScan system is a portable device consisting of a hand-held control unit, an interchangeable measurement head and a separate charging unit. To perform a measurement, the operator places the measurement head on the objective area and presses a button. Each measurement takes less than five seconds with results displayed and stored in system memory. The MicroScan can store 700 measurements in 255 files and provides the capability to program pass/fail criteria. Software is available for control, analysis and file conversion. From a single measurement, a user can determine RMS surface roughness, reflectance and scatter light levels (BRDF) on either flat or curved surfaces and under any lighting conditions.

Competition

Management believes the TMS and Lasercheck surface measurement products are two of only a few systems that provide fast, accurate, repeatable non-contact microroughness measurement for a wide variety of commercial customers. The Company believes its surface measurement products are currently the only systems that can provide measurements as low as a few hundredths of an Å, with reproducibility +/- 0.2Å or 1% and repeatability of +/-0.1Å. There are differences between our surface measurement products and other optical techniques (which include profilometers, scanning tunneling microscopes, atomic force microscopes or interferometers). These other technologies require the intervention of a skilled operator to perform measurements relatively slowly, whereas our surface measurement products are much simpler and, consequently, can make measurements more rapidly while still maintaining excellent repeatability and accuracy. Stylus profilometers are simpler devices that require less skilled operators. However, measurements must be conducted under vibration isolation conditions, and large areas require numerous scans; thus, stylus profilometers are generally destructive to soft materials such as most coated optics.

The market for distance measurement and dimensional sizing products is extremely competitive, characterized by rapidly changing technology. The Company believes the principal elements of competition include quality of ongoing technical support and maintenance coupled with responsiveness to customer needs, as well as price, product quality, reliability and performance. The differences between the Company s sensors and competitive products include pushbutton selection of output signals in certain models and sensors that can be programmed using serial commands through a PC computer.

Competing surface measurement products and dimensional sizing products come from established multinational competitors, most of which are significantly larger and have greater financial, engineering, manufacturing and marketing resources. Company pricing is intended to obtain market share and meet competitive supplier prices. The market strategy is to establish measurement products with the best quality, reliability and performance and superior economic value.

Remote Tank Monitoring Products

The Company s Xact Tank Monitoring System provides remote fill level monitoring of propane, diesel and other tank-based liquids for tanks, large or small, anywhere in the world. Accessing accurate fill level information is essential to effectively manage inventory, improve delivery efficiency, reduce operating costs and increase profitability, and justify capital expenditures. The Xact system utilizes an ultrasonic sensor that is applied externally to the tank to calculate the fill level inside the tank with great accuracy (+/- 2% for large tanks, +/-1% for small tanks). The Xact system can also be installed to measure the fill levels of bobtail and transport trucks. For smaller tanks that are difficult to access or where the precise accuracy provided by the ultrasonic sensor is not as important, Xact also offers a sensor that is affixed to the dial of a preinstalled float gauge (known as a gauge reader) which detects the fill level that is reported by the gauge. Float gauges have a typical accuracy of +/- 8% to 12%. Tank fill data is then transmitted via the Globalstar® satellite network to a secure website for display. There is no reliance on phone land lines or cellular networks and therefore no dropped data. The use of satellite telemetry permits monitoring of any tank anywhere in the world. With the Xact system, minimum or maximum alarm or fill levels can be set to automatically notify operators by email anytime a particular tank reading exceeds thresholds or needs refilling. The Xact system can be used to monitor tanks as small as 125 gallons (473 liters) and as large as 90,000 gallons (340,686 liters). With Xact, operators can obtain timely and accurate readings of inventory levels and tank refill requirements instantly.

There are three main components to the Xact Tank Monitoring System:

Tank Sensor

The Xact ultrasonic sensor incorporates patented technology and is externally mounted to the bottom of the tank. The sensor produces a small electrical pulse, or a ping, that travels through the tank s steel shell, which is reflected off the bottom surface of the liquid stored in the tank in the form of an echo that is

detected by the sensor. The time of flight between the ping and the echo, which is measured in milliseconds, is then calculated to determine, based upon additional data regarding tank size and shape, the volume of liquid the tank contains. This information is then remotely transmitted via a satellite radio transmitter. For smaller tanks that are difficult to access or where the precise accuracy provided by the ultrasonic sensor is not as important, Xact also offers a sensor that is affixed to the dial of a preinstalled float gauge (known as a gauge reader).The gauge reader detects the fill level that is reported by the gauge and transmits that data by satellite in the same manner as the ultrasonic sensor. Float gauges have a typical accuracy range of +/- 8% to 12%.

Satellite Radio Transmitter

The Xact radio transmitter is placed on the top of the tank and is connected by cable to the tank sensor or gauge reader. The satellite transmitter transmits the tank data using the GlobalStar® satellite network to a GlobalStar® ground station and then to the Xact secure website where the tank data is displayed or is automatically directed to a customer s automated inventory or delivery management system.

Xact Website

The Xact website is a secured location providing controlled access to the tank data for each customer s various tank locations. The tank fill level data and geometry of the tank are used to calculate and display the precise fill level at predetermined measurement times along with additional information such as temperature, battery status, GPS coordinates and map location, fill levels that trigger email notification and the list of email recipients. In addition to the data being displayed on the website, the data can also be automatically directed to a customer s automated inventory or delivery management system for full automation of the delivery process. Operators can now obtain highly accurate readings and tank information from even the most remote tanks conveniently and cost-effectively using their desktop computer, laptop, tablet or smart phone.

Benefits

Benefits of using the Xact Tank Monitoring System include external mounting with no reliance on existing mechanical gauges when using the ultrasonic sensors, tank fill data is sent directly and instantly from the tank to the user via satellite, no reliance on telephone lines or cellular networks and no dropped data, temperature adjusted readings for accuracy within +/- 2% for large tanks and +/- 1% for smaller tanks when using the ultrasonic sensor, user-set alarm levels and automatic low tank-level messaging via email or cell phone, the ability to operate in a wide range of operating environments from -40ºC to 60ºC, long battery life, quick and easy installation, secure data transmission via satellite, the ability to integrate directly into delivery scheduling management systems and the ability to monitor any tank anywhere in the world.

Customers

Customers of the Xact Tank Monitoring System include large, regional and local propane distributors, such as Superior Propane (Canada), Suburban Propane (U.S.), AmeriGas (U.S.), Pacific Propane (U.S.) and TermoGas (Mexico). The Company is focusing its business development efforts on the propane industry in the United States, Canada, Mexico, Central and South America.

Competition

Management believes that the Xact Tank Monitoring System offers the only ultrasonic sensor specifically designed to provide independent precise tank level calculation while most other competitors utilize gauge-reading technology, which reads the tank fill level from a pre-installed float gauge and is less accurate. Competitors offer telemetry options based on cellular or closed loop communication networks whereas Xact telemetry is satellite based. Competitors include, but are not limited to, Independent Technologies, Inc. (Wesroc), NasCorp (SkyTracker), WacnGo, Silicon Controls, TankLink, Centeron, TankScan and Enertrack.

In Fiscal 2015, 2014 and 2013, net sales of Measurement products totaled $5,218,855, $4,413,295 and $4,738,130, respectively, and accounted for 40%, 36% and 38% of the Company s total sales in Fiscal 2015, 2014 and 2013, respectively. See Note 6 to Consolidated Financial Statements.

Sales by Geographic Area

In Fiscal 2015, 2014 and 2013, the Company recorded net sales of its products in the United States, its country of domicile, of $7,174,257, $6,704,239 and $7,431,528, respectively. Net sales in the last three fiscal years by geographic areas were:

	North America	Europe	Asia	Others
Fiscal 2015	$ 8,165,268	$ 1,194,186	$ 3,388,757	$ 320,880
Fiscal 2014	$ 7,474,067	$ 1,773,928	$ 2,693,767	$ 192,744
Fiscal 2013	$ 8,413,970	$ 1,192,049	$ 2,499,593	$ 346,640

Business and Marketing Strategy

The Company designs, manufactures and markets all of its products with operations divided into a number of different channels and geographies.

Balancer Segment Products

The Company markets and sells its SBS products in a variety of ways. First are the channels provided by independent manufacturers representatives and distributors. There are currently approximately 65 individuals and/or organizations throughout the world acting in one of these capacities, including approximately 15 in the United States and 15 in China.

Second, OEMs integrate the Balancer Segment products on the machine tools they produce. Users thus purchase the SBS products concurrently with the machine tools. Conversely, end users of grinding machines that have purchased the SBS system directly from the Company, and after enjoying the benefits of the products, often request that SBS products be included with the new equipment they order from OEMs. The SBS Systems are often installed by machine tool builders prior to displaying their own machine tools at various trade shows, becoming endorsements that prove beneficial to the Company s sales efforts.

Third, worldwide trade shows have proven to be an excellent source of business. Company representatives, usually one or more of the marketing managers and the CEO, attend these events along with local Company representatives. These individuals operate a display booth featuring an SBS System demonstration stand and product and technical literature. Representatives from all facets of the Company s target markets attend these trade shows.

In North America and Asia, products are shipped directly to customers from the Company s factory in Portland, Oregon. Where the Company has distributors, the product is shipped to the distributor, who in turn pays the Company directly and then delivers and installs the product for the end user. European distribution to customers is handled by shipping the product directly from the Company s Portland headquarters to its European subsidiary in the United Kingdom, which in turn sells and distributes the products.

Measurement Segment Products

Similar to the Balancer Segment, the Measurement Segment uses a variety of methods to market and sell its products. First, sales and marketing managers direct the overall worldwide marketing efforts for surface measurement, laser and white light sensor and remote tank monitoring products. Second, both a marketing manager and a sales manager direct the overall worldwide marketing and sales efforts for distance measurement

and dimensional sizing products. Third, the Company uses distributors for international markets for the promotion and sale of surface measurement products in China, Taiwan, Japan and Korea. The Xact product line utilizes two business development personnel, in addition to distributors for selected markets. All Measurement Segment products are assembled in the Portland, Oregon facility and shipped worldwide directly to customers.

Backlog

The Company does not generally track backlog. Normally, orders are shipped within one to two weeks after receipt unless the customer requests otherwise.

Manufacturing

There are no unique sources of supply or raw materials in any product lines. Essential electronic components, available in large quantities from various suppliers, are assembled into the Balancing and Measurement electronic control units under the Company s quality and assembly standards. Company-owned software and firmware are coupled with the electronic components to provide the basis of the Company s various electronic control units. Management believes several supply sources exist for all electronic components and assembly work incorporated into its electronic control systems. Mechanical parts for the Company s products are produced by high quality machine shops. The Company is not dependent on any one supplier of mechanical components. In the event of supply problems, the Company believes that two or three alternatives could be developed within 30 days. The Company is subject to availability and pricing on the various components parts purchased, which has had, and may continue to have, a material impact on operations.

The Company uses in-house skilled assemblers to construct and test vendor-supplied components. Component inventory of finished vendor-supplied parts is held on Company property to assure adequate flow of parts to meet customer order requirements. Inventory is monitored by a computer control system designed to assure timely re-ordering of components. In-house personnel assemble various products and test all finished components before placing them in the finished goods inventory. Finished goods inventory is maintained via computer to assure timely shipment and service to customers. All customer shipments are from the finished goods inventory.

The Company s Quality Control Program first received full ISO 9001 certification in 1996. In 2005, the Company received its certification to the newer ISO 9001:2000 requirements and in 2011 and 2014 received its recertification.

Proprietary Technology

The Company s success depends in part on its proprietary technology, which the Company protects through patents, copyrights, trademarks, trade secrets and other measures. The Company has U.S. patents covering both Balancer and Measurement products, processes and methods that the Company believes provide it with a competitive advantage. The Company has a policy of seeking patents where appropriate on inventions concerning new products and improvements developed as part of its ongoing research, development and manufacturing activities. While patents provide certain legal rights of enforceability, there can be no assurance the historic legal standards surrounding questions of validity and enforceability will continue to be applied or that current defenses with respect to issued patents will, in fact, be considered substantial in the future. There can be no assurance as to the degree and range of protection any patent will afford and whether patents will be issued or the extent to which the Company may inadvertently infringe upon patents granted to others.

The Company manufactures its Balancer Segment products under copyright protection in the U.S. for electronic board designs. Encapsulation of the finished product further protects the Company s technologies including software.

The Company also relies upon trade secret protection for its confidential and proprietary information. There can be no assurance that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to the Company s trade secrets or disclose such technology or that the Company can meaningfully protect its trade secrets.

While the Company pursues patent, trademark, trade secret and copyright protection for products and various trademarks, it also relies on know-how and continuing technology advancement, manufacturing capabilities, affordable high-quality products, new product introduction and direct marketing efforts to develop and maintain its competitive position.

Product Development

The Company maintains an ongoing research and development program to expand the product lines and capabilities of its business segments. The goal of this program is to expand the product base in historic markets and to enter new market areas so as to reduce reliance on historic market segments. During Fiscal 2015, 2014 and 2013, the Company s research and development expense totaled $378,305, $475,430 and $573,461, respectively.

Employees

As of July 31, 2015, the Company employed 56 individuals worldwide on a full-time basis. There was also one part-time employee. None of the Company s employees are covered by a collective bargaining agreement.

Item 1A. RISK FACTORS

The following are important 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 (see the forward-looking statements disclaimer at the beginning of Part 1, Item 1 in this Report). In addition, the risks and uncertainties described below are not the only ones that the Company faces. Unforeseen risks could arise and problems or issues that the Company now views as minor could become more significant. If the Company were unable to adequately respond to any risks, the Company s business, financial condition or results of operations could be materially adversely affected. In addition, the Company cannot be certain that any actions taken to reduce known or unknown risks and uncertainties will be effective.

General economic conditions and uncertainties may adversely affect the Company s business, operating results and financial condition

The Company s operations and performance depend significantly on worldwide economic conditions, particularly in the industrial, manufacturing and automotive sectors in the U.S., Asia and Europe, and their impact on levels of capital spending, which have deteriorated significantly in the past and may become depressed, or be subject to further deterioration. Economic factors that could adversely influence demand for the Company s products include uncertainty about global economic conditions leading to reduced levels of investment, reduction in demand for our customers products, customers and suppliers access to credit and the stability of the global financial system, the overall health of our markets, unemployment and other macroeconomic factors generally affecting commercial and industrial spending behavior.

The past distress in the global financial markets and global economy has resulted in reduced liquidity and a tightening of credit markets. As a result of these conditions, the Company could experience several potential adverse effects, including the inability of customers to obtain credit to finance purchases of the Company s products, the insolvency of customers resulting in reduced sales and bad debts, and the insolvency of key suppliers resulting in product development and production delays.

The Company s primary markets are volatile and unpredictable

The Company s business depends on the demand for our various products in a variety of commercial and industrial markets. In the past, demand for our products in these markets has fluctuated due to a variety of factors, some of which are beyond our control, including: general economic conditions, both domestically and internationally, the timing, number and size of orders from, and shipments to, our customers as well as the relative mix of those orders and variations in the volume of orders for a particular product line in a particular quarter.

The Company s efforts to continue to accelerate growth of the Xact Tank Monitoring System may not be successful

The Xact Tank Monitoring System, which was introduced by the Company in 2009, measures the fill levels of tanks holding propane, diesel and other tank-based liquids and communicates that data via satellite to a secure web site. Although the initial acquisition and further development of the Xact product line have negatively impacted operating results, the product line is adding sales and profits to the Company. The Company s efforts to continue to accelerate the growth of Xact in its two primary markets of North America and Latin America may not be successful, anticipated market demand for the products may not materialize, and additional products or market opportunities may not be identified, developed and brought to market in a timely and cost-effective manner. All of this could continue to negatively impact future operating results and result in large and immediate write-offs of recorded intangible asset balances.

New products may not be developed to satisfy changes in consumer demands

The failure to develop new products or enhance existing products or react to changes in existing technologies could result in decreased revenues and a loss of market share to competitors. Financial performance depends on the ability to design, develop, manufacture, assemble, test, market and support new products and enhancements on a timely and cost-effective basis. New product opportunities may not be identified and developed and brought to market in a timely and cost-effective manner. Products or technologies developed by other companies may render products or technologies obsolete or noncompetitive, or a fundamental shift in technologies in the product markets could have a material adverse effect on the Company s competitive position within historic industries.

Competition is intense and the Company s failure to compete effectively would adversely affect its business

Competition in the markets for the Company s products is intense. The speed with which the Company can identify new applications for the Company s various technologies, develop products to meet those needs and supply commercial quantities at low prices to those new markets are important competitive factors. The principal competitive factors in the Company s markets are product features, performance, reliability and price. Many of the Company s competitors have greater financial, technical, engineering, production and marketing resources than we do. Those competitors with greater resources may, in addition to other things, be able to better withstand periodic downturns, compete more effectively on the basis of price and technology, or more quickly develop enhancements to products that compete with the products we manufacture and market. New companies may enter the markets in which we compete, further increasing competition in those markets. No assurance can be given that the Company will be able to compete effectively in the future, and the failure to do so would have a material adverse effect on the Company s business, financial condition and results of operations.

The Company may experience increased pricing pressure

We have experienced and continue to experience pricing pressure in the sale of our products, from both competitors and customers. Pricing pressures typically have become more intense during cyclical downturns when competitors seek to maintain or increase market share, reduce inventory or introduce more technologically advanced products or lower cost products. In addition, we may agree to pricing concessions or extended payment terms with our customers in connection with volume orders or to reduce cost of ownership in highly competitive applications. Our business, financial condition, margins or results of operations may be materially and adversely affected by competitive pressure and intense price-based competition.

The Company may experience uncertainties resulting from conflict minerals regulation

On August 22, 2012, the SEC adopted a new rule requiring disclosures of specified minerals, known as conflict minerals, that are necessary to the functionality or production of products manufactured or contracted to be manufactured by companies filing public reports. The new rule requires a disclosure report to be filed annually with the SEC and this report will require companies to perform due diligence, disclose and report whether such minerals originate from the Democratic Republic of Congo or an adjoining country. The new rule could affect

sourcing at competitive prices and availability in sufficient quantities of certain minerals used in the manufacture of our products. The number of suppliers who provide conflict-free minerals may be limited. In addition, there may be material costs associated with complying with the disclosure requirements, such as costs related to determining the source of certain minerals used in our products as well as costs of possible changes to products, processes, or sources of supply as a consequence of such verification activities. Since our supply chain is complex, we may not be able to sufficiently verify the origins of the relevant minerals used in our products through the due diligence procedures that we implement, which may harm our reputation. In addition, we may encounter challenges to satisfy those customers who require that all of the components of our products be certified as conflict-free, which could place us at a competitive disadvantage if we are unable to do so.

Production time and the overall cost of products could increase if any of the primary suppliers are lost or if a primary supplier increased the prices of raw materials

Manufacturing operations depend upon obtaining adequate supplies of raw materials on a timely basis. The results of operations could be adversely affected if adequate supplies of raw materials cannot be obtained in a timely manner or if the costs of raw materials increased significantly.

The Company may not be able to ramp up manufacturing to satisfy increasing orders, which may lead to the loss of significant revenue opportunities

The Company manufactures several different product lines, all of which involve complicated technology and individual attention for each product made. The production time for each product can vary, depending on a variety of circumstances, including component availability, timing of delivery of components from suppliers and employee availability. Should the Company receive a large increase in orders, an increase in the size of orders or a shortening of the required delivery time on existing orders, the Company may not be able to ramp up manufacturing to satisfy customer expectations, which may lead to the loss of significant revenue opportunities.

The Company maintains a significant investment in inventories in anticipation of future sales

The Company believes it maintains a competitive advantage by shipping product to its customers more rapidly than its competitors. As a result, the Company has a significant investment in inventories. These inventories are recorded using the lower of cost or market method, which requires management to make certain estimates. Management evaluates the recorded inventory values based on customer demand, market trends and expected future sales, and changes these estimates accordingly. A significant shortfall of sales may result in carrying higher levels of inventories of finished goods and raw materials thereby increasing the risk of inventory obsolescence and corresponding inventory write-downs. As a result, the Company may not carry adequate reserves to offset such write-downs.

The Company s existing cash may not be sufficient and the Company may not be able to obtain financing to fund operations or future growth

The Company had a cash balance of $1.8 million as of May 31, 2015 and has no bank line of credit facility. The Company believes that its existing cash and investments combined with the cash from operating activities will be sufficient to meet its cash requirements for the near term. However, if sales weaken or the Company needs to fund growth, and the Company is unable to reduce its operating costs in a timely manner or access additional financing through commercial loans or capital fund raising at terms acceptable to the Company and its shareholders, the liquidity or operations of the Company may be significantly impacted.

Fluctuations in quarterly and annual operating results make it difficult to predict future performance

Quarterly and annual operating results are likely to fluctuate in the future due to a variety of factors, some of which are beyond management s control. As a result of quarterly operating fluctuations, it is important to realize

quarter-to-quarter comparisons of operating results are not necessarily meaningful and should not be relied upon as indicators of future performance.

The Company faces risks from international sales and currency fluctuations

The Company markets and sells its products worldwide and international sales have accounted for and are expected to continue to account for a significant portion of future revenue. International sales are subject to a number of risks, including: the imposition of governmental controls; trade restrictions; difficulty in collecting receivables; changes in tariffs and taxes; difficulties in staffing and managing international operations; political and economic instability; general economic conditions; and fluctuations in foreign currencies. No assurances can be given that these factors will not have a material adverse effect on future international sales and operations and, consequently, on our business, financial condition and results of operations.

The Company may experience a downturn due to the risks of operating a global business

Sales to customers outside the U.S. accounted for 45.1% of total sales in Fiscal 2015. We expect that sales to customers outside the U.S. will continue to represent a significant percentage of sales in the future. We currently have a sales and service office in Coventry, England and a sales office in Shanghai, China. We may need to increase our foreign operations in the future. Our international sales, purchases and operations are subject to risks inherent in conducting business abroad, many of which are outside of our control, including periodic local or geographical economic downturns, fluctuations in the relative values of currencies, difficulties in protecting intellectual property, shipping delays and disruptions, local labor disputes, unexpected changes in trading policies, regulatory requirements, tariffs and duties and difficulties in managing a global presence, including staffing, collecting accounts receivable, and managing distributors and sales representatives.

The Company may not be able to reduce operating costs quickly enough if sales decline

Operating expenses are generally fixed in nature and largely based on anticipated sales. However, should future sales decline significantly and rapidly, there is no guarantee management could take actions that would further reduce operating expenses in either a timely manner or without seriously impacting the operations of the Company.

Future success depends in part on attracting and retaining key management and qualified technical and sales personnel

Future success depends on the efforts and continued services of key management, technical and sales personnel. Significant competition exists for such personnel and there is no assurance key technical and sales personnel can be retained or that other highly qualified technical and sales personnel as required can be attracted, assimilated and retained. There is also no guarantee that key employees will not leave and subsequently compete against the Company. The inability to attract and retain key personnel could adversely impact the business, financial condition and results of operations.

Changes in the effective tax rate may have an adverse effect on the Company s results of operations

The Company s future effective tax rate may be adversely affected by a number of factors including: the jurisdictions in which profits are determined to be earned and taxed; the resolution of issues arising from future, potential tax audits with various tax authorities; changes in the valuation of our deferred tax assets and liabilities; adjustments to estimated taxes upon finalization of various tax returns; increases in expenses not deductible for tax purposes; changes in available tax credits; changes in stock-based compensation expense; changes in tax laws or the interpretations of such tax laws and changes in generally accepted accounting principles.

Failure to protect intellectual property rights could adversely affect future performance and growth

Failure to protect existing intellectual property rights may result in the loss of valuable technologies or paying other companies for infringing on their intellectual property rights. The Company relies on patent, trade secret, trademark and copyright law to protect such technologies. There is no assurance any of the Company s U.S. patents will not be invalidated, circumvented, challenged or licensed to other companies.

Changes in securities laws and regulations have increased and could continue to increase Company expenses

Changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and rules promulgated by the Securities and Exchange Commission, have increased and may continue to increase Company expenses as the Company devotes resources to ensure compliance with all applicable laws and regulations. In addition, the NASDAQ Capital Market, on which the Company s common stock is listed, has also adopted comprehensive rules and regulations relating to corporate governance. These laws, rules and regulations have increased the scope, complexity and cost of corporate governance, reporting and disclosure practices. The Company may be required to hire additional personnel and use outside legal, accounting and advisory services to address these laws, rules and regulations. The Company also expects these developments to make it more difficult and more expensive for the Company to obtain director and officer liability insurance in the future, and the Company may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. Further, the Company s board members, Chief Executive Officer and Chief Financial Officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which would adversely affect the Company.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company s design and assembly facilities and executive offices are located in Portland, Oregon in three company-owned buildings totaling approximately 40,500 square feet. SEL occupies a 1,080-square foot facility in Coventry, England pursuant to a three-year lease, renewable for an additional three-year period. In March 2014, the Company exercised the lease renewal. The current basic monthly rent amount is £1,002 ($1,531 as of May 31, 2015) and the lease will expire in March 2017.

Item 3. Legal Proceedings

There are no material legal proceedings currently pending against the Company.

Item 4. Mine Safety Disclosures

None.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company s Common Stock is traded on the NASDAQ Capital Market under the symbol SMIT.

The following tables set forth the high and low closing prices of the Company s Common Stock as reported on the NASDAQ Capital Market for the periods indicated.

Year Ended May 31, 2014	High	Low
First Quarter	$ 3.05	$ 2.51
Second Quarter	$ 2.70	$ 2.44
Third Quarter	$ 2.70	$ 2.51
Fourth Quarter	$ 3.03	$ 2.65

Year Ended May 31, 2015	High	Low
First Quarter	$ 3.06	$ 2.65
Second Quarter	$ 3.20	$ 2.70
Third Quarter	$ 2.99	$ 2.65
Fourth Quarter	$ 2.80	$ 2.62

As of July 31, 2015, there were 2,995,910 shares of Common Stock outstanding held by approximately 71 holders of record. The number of holders does not include individual participants in security position listings; the Company believes that there are more than 900 individual holders of shares of Common Stock.

The Company has not paid any dividends on its Common Stock since 1994. The Company s current policy is to retain earnings to finance the Company s business. Future dividends will be dependent upon the Company s financial condition, results of operations, current and anticipated cash requirements, acquisition plans and plans for expansion and any other factors that the Company s Board of Directors deems relevant. The Company has no present intention of paying dividends on its Common Stock in the foreseeable future.

This table shows information about equity awards under the Company s equity compensation plans at May 31, 2015:

Plan Category	Number of Securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options (b)	Number of Securities remaining available for future issuance under equity compensation plans (excluding securities in column a) (c)
Equity compensation plans approved by security holders	332,500	$ 3.68	212,500
Equity compensation plans not approved by security holders	0	0	0
	332,500	$ 3.68	212,500

Recent Sales of Unregistered Securities

None.

Issuer Purchases of Equity Securities

None.

Item 6. Selected Financial Data
In thousands, except per share information

Year Ended	5/31/2015	5/31/2014	5/31/2013	5/31/2012	5/31/2011
Net sales	$ 13,069	$ 12,135	$ 12,452	$ 14,437	$ 11,493
Net income (loss)	$ (94)	$ (540)	$ (540)	$ 77	$ (205)
Net income (loss) per common share, basic	$ (0.03)	$ (0.18)	$ (0.18)	$ 0.03	$ (0.07)
Weighted average number of common shares, basic	2,996	2,996	2,991	2,930	2,895
Net income (loss) per common share, diluted	$ (0.03)	$ (0.18)	$ (0.18)	$ 0.03	$ (0.07)
Weighted average number of common shares, diluted	2,996	2,996	2,991	2,944	2,895
Stockholders equity	$ 9,489	$ 9,613	$ 10,015	$ 10,484	$ 10,157
Total assets	$ 11,104	$ 10,824	$ 11,625	$ 12,026	$ 11,589
Long-term debt (including current portion)	$ 0	$ 0	$ 0	$ 0	$ 0

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations
RESULTS OF OPERATIONS

Overview

Schmitt Industries, Inc. (the Company), an Oregon corporation, designs, manufactures and sells high precision test and measurement products for two main business segments: the Balancer segment and the Measurement segment. For the Balancer segment, the Company designs, manufactures and sells computer-controlled vibration detection, balancing and process control systems for the worldwide machine tool industry, particularly for grinding machines. Through its wholly owned subsidiary, Schmitt Measurement Systems, Inc., an Oregon corporation, the Company designs, manufactures and sells laser and white light sensors for distance, dimensional and area measurement for a wide variety of commercial applications, laser-based microroughness measurement products for the semiconductor wafer and hard disk drive industries and for other industrial applications, laser-based surface analysis and measurement products for a variety of scientific applications, and ultrasonic measurement products that accurately measure the fill levels of tanks holding propane, diesel and other tank-based liquids and transmit that data via satellite to a secure web site for display (the Measurement segment). The Company also provides sales and service for Europe and Asia through its wholly owned subsidiary, Schmitt Europe Limited (SEL), located in Coventry, England and through its sales representative office located in Shanghai, China.

For the fiscal year ended May 31, 2015 (Fiscal 2015), total sales increased $934,585, or 7.7%, to $13,069,091 from $12,134,506 in the fiscal year ended May 31, 2014 (Fiscal 2014). Balancer segment sales focus throughout the world on end-users, rebuilders and original equipment manufacturers of grinding machines with the target geographic markets of North America, Asia, and Europe. Balancer sales increased $129,025, or 1.7%, to $7,850,236 in Fiscal 2015 compared to $7,721,211 in Fiscal 2014. Sales into Asia, Germany and other European countries increased $712,846, or 23.8%, for Fiscal 2015 as compared to Fiscal 2014. These sales were offset by lower volumes of shipments into North America and other regions of the world. The Measurement segment product lines consist of SMS and Lasercheck laser-based surface microroughness measurement systems, Acuity laser-based distance measurement and dimensional sizing laser sensors, and Xact ultrasonic-based remote tank monitoring products. Total Measurement segment sales increased $805,560, or 18.3%, to $5,218,855 for the year ended May 31, 2015 as compared to $4,413,295 for the year ended May 31, 2014. The increase is primarily increased revenues associated with the sales of Xact remote tank monitoring products and related monitoring services and an increase in sales of SMS laser-based surface measurement products.

Operating expenses increased $66,605, or 1.1%, to $6,205,156 in Fiscal 2015 from $6,138,551 in Fiscal 2014. General, administrative and sales expenses increased $163,730, or 2.9%, in Fiscal 2015 to $5,826,851 as compared to $5,663,121 in the prior fiscal year. Research and development expenses decreased $97,125, or 20.4%, to $378,305 in Fiscal 2015 from $475,430 in Fiscal 2014.

Net loss was $93,669, or $0.03 per fully diluted share, for the year ended May 31, 2015 as compared to net loss of $539,624, or $0.18 per fully diluted share, for the year ended May 31, 2014.

Critical Accounting Policies

Revenue Recognition The Company recognizes revenue for sales and billing for freight charges upon delivery of the product to the customer at a fixed or determinable price with a reasonable assurance of collection, passage of title to the customer as indicated by shipping terms and fulfillment of all significant obligations, pursuant to the guidance provided by Accounting Standards Codification 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.

Allowance for Doubtful Accounts 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 accounts receivable agings, other operating trends and relevant business conditions, including general economic factors, as they relate to 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.

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.

Deferred Taxes The Company applies the asset and liability method in recording income taxes, under which deferred income tax assets and liabilities are determined, based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using currently enacted tax rates and laws. Additionally, deferred tax assets are evaluated and a valuation allowance is established if it is more likely than not that all or a portion of the deferred tax asset 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 so that the deferred tax assets can be fully utilized.

Intangible Assets Intangible and other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. Recoverability is determined by comparing the forecasted future undiscounted net cash flows from the operations to which the assets relate, based on management s best estimates using the appropriate assumptions and projections at the time, to the carrying amount of the assets. If the carrying value is determined to be in excess of future operating cash flows, the asset is considered impaired and a loss is recognized equal to the amount by which the carrying amount exceeds the estimated fair value of the assets.

Recently issued accounting pronouncements

Refer to Note 2 of the Notes to Consolidated Financial Statements for a discussion of recently issued accounting pronouncements.

Discussion of Operating Results

	Year Ended May 31,					
	2015		2014		2013	
Balancer sales	$ 7,850,236	60.1%	$ 7,721,211	63.6%	$ 7,714,122	61.9%
Measurement sales	5,218,855	39.9%	4,413,295	36.4%	4,738,130	38.1%
Total sales	13,069,091	100.0%	12,134,506	100.0%	12,452,252	100.0%
Cost of sales	6,928,394	53.0%	6,508,360	53.6%	6,357,452	51.1%
Gross profit	6,140,697	47.0%	5,626,146	46.4%	6,094,800	48.9%
Operating expenses:						
General, administration and sales	5,826,851	44.6%	5,663,121	46.7%	6,083,611	48.9%
Research and development	378,305	2.9%	475,430	3.9%	573,461	4.6%
Total operating expenses	6,205,156	47.5%	6,138,551	50.6%	6,657,072	53.5%
Operating loss	(64,459)	(0.5%)	(512,405)	(4.2%)	(562,272)	(4.5%)
Other income (expense)	(19,123)	(0.1%)	(17,887)	(0.1%)	14,106	0.1%
Loss before income taxes	(83,582)	(0.6%)	(530,292)	(4.4%)	(548,166)	(4.4%)
Provision (benefit) for income taxes	10,087	0.1%	9,332	0.1%	(8,284)	(0.1%)
Net loss	$ (93,669)	(0.7%)	$ (539,624)	(4.4%)	$ (539,882)	(4.3%)

Sales Sales in the Balancer segment increased $129,025, or 1.7%, to $7,850,236 for Fiscal 2015 compared to $7,721,211 for Fiscal 2014. This increase was primarily attributed to stronger sales in Asia and other regions of the world, offset by lower shipments into North America and Europe. Sales into Asia increased $574,923, or 24.0%, and sales into other regions of the world increased $126,352, or 117.0%, during Fiscal 2015 as compared to Fiscal 2014. North American sales decreased $530,905, or 13.0%, in Fiscal 2015 compared to Fiscal 2014. While sales into Europe decreased $41,345, or 3.7%, in Fiscal 2015 compared to Fiscal 2014, sales into Germany and other European countries increased $137,923, or 18.9% in Fiscal 2015 compared to the prior year. The increases in sales into Asia and other regions of the world were due to an increase in demand for the Company s SBS products, while the increase in sales into Germany and other European countries is in response to the targeted market strategy we have in those areas. The decline in sales in North America reflected fluctuations in demand in the markets we serve. The levels of demand for our Balancer products in any of these geographic markets cannot be forecasted with any certainty given current economic trends and the historical volatility experienced in this market.

Sales in the Measurement segment increased $805,560, or 18.3%, to $5,218,855 in Fiscal 2015 compared to $4,413,295 in Fiscal 2014. Sales of Acuity laser-based distance measurement and dimensional-sizing products decreased $499,937, or 20.1%, primarily due to a reduction in the markets we serve. Sales of Xact remote tank monitoring products increased $723,595, or 74.4%, to $1,695,939 during Fiscal 2015 due to an increase in product shipments and increasing monitoring revenues associated with unit sales. Sales of SMS and Lasercheck laser-based surface measurement products increased $581,902, or 61.3%, primarily due to an increase in demand for these products. Future sales of laser-based or ultrasonic measurement products cannot be forecasted with any certainty given the historical volatility experienced in this market.

Sales in the Balancer segment increased $7,089, or 0.1%, to $7,721,211 for Fiscal 2014 compared to $7,714,122 for Fiscal 2013. This increase was primarily due to increased sales into Europe and Asia, offset by lower

shipments into North America and other regions of the world. Sales into Europe increased $199,287, or 21.5%, in Fiscal 2014 compared to Fiscal 2013. Sales into Asia increased $145,137, or 6.4%, in Fiscal 2014 compared to the prior year. North American sales decreased $218,349, or 5.1%, in Fiscal 2014 compared to Fiscal 2013. Sales in other regions of the world decreased $118,986, or 52.4%, during Fiscal 2014 as compared to the prior year. The increases in sales in Europe and Asia were due to a gradual increase in demand for the Company s SBS products, while the decline in sales in North America and other regions of the world reflected fluctuations in demand due to uncertainties about the pace of economic recovery in the markets we serve. The levels of demand for our Balancer products in any of these geographic markets cannot be forecasted with any certainty given current economic trends and the historical volatility experienced in this market.

Sales in the Measurement segment decreased $324,835, or 6.9%, to $4,413,295 in Fiscal 2014 compared to $4,738,130 in Fiscal 2013. Sales of Acuity laser-based distance measurement and dimensional-sizing products decreased $626,701, or 20.1%, primarily due to a reduction in orders as the uncertainty and inconsistency in the U.S. economic recovery continues to have a negative impact in the markets we serve. Sales of SMS and Lasercheck laser-based surface measurement products increased $206,175, or 27.7%, primarily due to an increase in demand for these products. Sales of Xact remote tank monitoring products increased $95,691 to $972,344 during Fiscal 2014 due to the higher volume of shipments and the developing monitoring revenues associated with unit sales. Future sales of laser- based or ultrasonic measurement products cannot be forecasted with any certainty given the historical volatility experienced in this market.

Gross margin Gross margin in Fiscal 2015 increased to 47.0% compared to 46.4% in Fiscal 2014. The variance in gross margin was primarily due to shifts in the product sales mix involving our five product lines. Gross margin in Fiscal 2014 decreased to 46.4% compared to 48.9% in Fiscal 2013. The variance in gross margin was primarily due to shifts in the product sales mix involving our five product lines and the impact of increased costs associated with the products sold.

Operating expenses Operating expenses increased $66,605, or 1.1%, to $6,205,156 for Fiscal 2015 compared to $6,138,551 for Fiscal 2014. General, administrative and sales expenses increased $163,730, or 2.9%, to $5,826,851 in Fiscal 2015 compared to $5,663,121 in the prior year. Increases in personnel costs and commissions expense were offset by decreases in professional fees, depreciation expense and other general office expenses. Research and development expenses decreased $97,125, or 20.4%, to $378,305 in Fiscal 2015 compared to $475,430 in Fiscal 2014. The decrease in research and development expense was primarily due to the timing of completion of some of the development projects occurring within our existing product lines, with new projects starting during the fourth quarter of Fiscal 2015.

Operating expenses decreased $518,521, or 7.8%, to $6,138,551 for Fiscal 2014 compared to $6,657,072 in Fiscal 2013. General, administrative and sales expenses decreased $420,490, or 6.9%, to $5,663,121 in Fiscal 2014 compared to $6,083,611 in the prior year. This decrease was the result of lower sales and marketing and travel and entertainment expenses. Research and development expenses decreased $98,031, or 17.1%, to $475,430 in Fiscal 2014 compared to $573,461 in Fiscal 2013. The decrease in research and development expense was primarily due to the completion of some of the development projects within our existing product lines.

Other income (expense) Other income (expense) consists of interest income, interest expense, foreign currency exchange gain (loss) and other income (expense). Interest income was $191, $1,558 and $1,226 in Fiscal 2015, 2014 and 2013, respectively. Fluctuations in interest income are impacted by the levels of our average cash and investment balances and changes in interest rates. Interest expense was $3,452, $9,158, and $0 in Fiscal 2015, 2014 and 2013, respectively. Fiscal 2015 interest expense is related to the capital lease of a piece of manufacturing equipment. Fiscal 2014 interest expense was related to the interest charges on the outstanding balances on our line of credit. Foreign currency exchange loss was $33,411 and $23,375 in Fiscal 2015 and 2014, respectively. Foreign currency exchange gain was $12,884 in Fiscal 2013. The foreign currency exchange gain (loss) fluctuated with the strength of foreign currencies against the U.S. dollar during the respective periods. In

Fiscal 2015 and 2014, other income included gains in the amounts of $17,500 and $13,667, respectively, which were the result of sales of certain fixed assets.

Income tax provision The effective tax rate in Fiscal 2015 was 12.1%. The effective tax rate on consolidated net loss in Fiscal 2015 differed 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, offset by tax credits related to research and experimentation expenses. The effective tax rate in Fiscal 2014 was 1.8%. The effective tax rate on consolidated net loss in Fiscal 2014 differed 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, offset by tax credits related to research and experimentation expenses. The effective tax rate in Fiscal 2013 was (1.5)%. The effective tax rate on consolidated net loss in Fiscal 2013 differed 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 offset by tax credits related to research and experimentation expenses.

Net income (loss) Net loss decreased $445,955 to a net loss of $93,669, or $0.03 per diluted share, for Fiscal 2015 as compared to net loss of $539,624, or $0.18 per diluted share, for Fiscal 2014. Net loss for Fiscal 2015 reflected increased sales and a higher gross margin percentage, which was partially offset by an increase in operating expenses. Net loss decreased $258 to a net loss of $539,624, or $0.18 per diluted share, for Fiscal 2014 as compared to net loss of $539,882, or $0.18 per diluted share, for Fiscal 2013. Net loss for Fiscal 2014 reflected decreased sales and a lower gross margin percentage, which was partially offset by reduced operating expenses.

Inflation Risk

The Company does not believe that inflation has had a material effect on its business, financial condition or results of operations. However, if its costs were to become subject to significant inflationary pressures, the Company may not be able to fully offset such higher costs through price increases. The Company s inability or failure to do so could harm its business, financial condition and results of operations.

Off Balance Sheet Arrangements

The Company did not have any off-balance sheet arrangements during the fiscal year ended May 31, 2015.

LIQUIDITY AND CAPITAL RESOURCES

The Company s working capital increased $75,242 to $7,553,315 as of May 31, 2015 compared to $7,478,073 as of May 31, 2014. Cash and cash equivalents increased $285,089 from $1,510,565 as of May 31, 2014 to $1,795,654 as of May 31, 2015.

Cash provided by operating activities was $390,146 in Fiscal 2015 as compared to cash used in operations of $392,376 in Fiscal 2014. The increase in the amount of cash used for operating activities was primarily due to the reduction in net loss incurred by the Company, reductions in inventories, and increases in accounts payable and accrued liabilities, offset by the increase in accounts receivable.

At May 31, 2015, accounts receivable increased $425,232 to $2,660,426 compared to $2,235,194 as of May 31, 2014. The increase in accounts receivable was due to the increase in sales in the fourth quarter and the resulting timing of receipts. Inventories decreased $232,255 to $4,557,567 as of May 31, 2015 compared to $4,789,822 as of May 31, 2014 as a result of our continued focus on right-sizing the levels of inventories held for each of the Company s product lines. At May 31, 2015, total current liabilities increased $404,247 to $1,615,331 as compared to $1,211,084 at May 31, 2014. The increase was primarily due to the timing of payments on accounts payable and increases in accruals for commissions resulting from the increase in fourth quarter sales.

During the year ended May 31, 2014, net cash used in investing activities was $49,127, which primarily consisted of additions to property and equipment of a new vehicle and new manufacturing and computer equipment, offset by the disposition of one of the Company s vehicles.

The Company had a $2 million bank line of credit secured by U.S. accounts receivable, inventories, general intangibles, and a depository account. The line of credit was subject to certain covenant requirements if draws on

the line were executed. Interest was payable at the bank s prime rate or LIBOR plus 2.0%. The term on the line of credit expired September 1, 2014, and the Company chose not to renew the line. There were no outstanding balances on the line of credit at May 31, 2015 and 2014.

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

QUARTERLY FINANCIAL DATA

In thousands, except per share information (unaudited)

2015 Quarter Ended	August 31	November 30	February 28	May 31
Sales	$ 3,049	$ 3,152	$ 3,011	$ 3,858
Gross profit	$ 1,464	$ 1,554	$ 1,350	$ 1,773
Net income (loss)	$ 52	$ (70)	$ (168)	$ 93
Net income (loss) per share, basic	$ 0.02	$ (0.02)	$ (0.06)	$ 0.03
Net income (loss) per share, diluted	$ 0.02	$ (0.02)	$ (0.06)	$ 0.03

2014 Quarter Ended	August 31	November 30	February 28	May 31
Sales	$ 2,899	$ 3,143	$ 3,066	$ 3,026
Gross profit	$ 1,331	$ 1,468	$ 1,458	$ 1,369
Net loss	$ (147)	$ (163)	$ (72)	$ (158)
Net loss per share, basic	$ (0.05)	$ (0.05)	$ (0.02)	$ (0.05)
Net loss per share, diluted	$ (0.05)	$ (0.05)	$ (0.02)	$ (0.05)

Item 7A. Quantitative and Qualitative Disclosures about Market Risk
Interest Rate Risk

The Company did not have any derivative financial instruments as of May 31, 2015. However, the Company could be exposed to interest rate risk at any time in the future and, therefore, employs established policies and procedures to manage its exposure to changes in the market risk of its cash equivalents.

The Company s interest income and expense are most sensitive to changes in the general level of U.S. interest rates. In this regard, changes in the U.S. interest rates affect the interest earned on the Company s interest bearing cash equivalents and short term investments. During Fiscal 2015, the Company allowed its variable rate line of credit facility with a bank to expire, and as such there was no outstanding balance as of May 31, 2015. Also, there is no other long-term obligation whose interest rates are based on variable rates that may fluctuate over time based on economic changes in the environment. Therefore, at this time, the Company is not subject to interest rate risk on outstanding interest bearing obligations if market interest rates fluctuate and does not expect any change in the interest rates to have a material effect on the Company s results from operations.

Foreign Currency Risk

The Company markets and sells its products worldwide and international sales have accounted for and are expected to continue to account for a significant portion of future revenue. The Company operates a subsidiary in the United Kingdom and acquires certain materials and services from vendors transacted in foreign currencies. Therefore, the Company s business and financial condition is sensitive to currency exchange rates or any other restrictions imposed on their currencies. For Fiscal 2015, 2014 and 2013, results of operations included gains (losses) on foreign currency translation of $(33,411), $(23,375) and $12,884, respectively. The foreign exchange gains or losses in Fiscal 2015, 2014 and 2013 are primarily attributable to Company s United Kingdom subsidiary, Schmitt Europe, Ltd.

Item 8. Financial Statements and Supplementary Data

SCHMITT INDUSTRIES, INC.

CONSOLIDATED BALANCE SHEETS

	May 31, 2015	May 31, 2014
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,795,654	$ 1,510,565
Accounts receivable, net	2,660,426	2,235,194
Inventories	4,557,567	4,789,822
Prepaid expenses	153,970	152,237
Income taxes receivable	1,029	1,339
	9,168,646	8,689,157
Property and equipment, net	1,110,878	1,191,591
Other assets		
Intangible assets, net	824,411	943,643
TOTAL ASSETS	$ 11,103,935	$ 10,824,391
LIABILITIES & STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 834,002	$ 512,219
Accrued commissions	284,944	204,772
Accrued payroll liabilities	140,872	127,035
Other accrued liabilities	355,513	366,848
Income taxes payable	0	210
Total current liabilities	1,615,331	1,211,084
Commitments and contingencies (Note 5)		
Stockholders equity		
Common stock, no par value, 20,000,000 shares authorized, 2,995,910 shares issued and outstanding at May 31, 2015 and May 31, 2014	10,511,324	10,438,750
Accumulated other comprehensive loss	(366,945)	(263,337)
Accumulated deficit	(655,775)	(562,106)
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