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, 1999

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: 0-23996

SCHMITT INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

Oregon	91-1151989
(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
None	None

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

Common Stock - no par value
(Title of each class)

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 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. [X]

As of August 18, 1999, the aggregate market value of the registrant's Common Stock held by nonaffiliates of the registrant was $8,645,079 based on the closing sales price of the registrant's Common Stock on the Nasdaq National Market. On that date, there were 8,184,889 shares of Common Stock outstanding.

Portions of the registrant's 1999 Annual Report to Shareholders are incorporated by reference into Parts II and IV hereof, and portions of the registrant's definitive Proxy Statement for its 1999 Annual Meeting of Shareholders are incorporated by reference into Part III hereof.

PART I

ITEM 1. BUSINESS

INTRODUCTION

The Company designs, assembles and markets computer-controlled balancing equipment for use primarily by the machine tool industry. Through its wholly owned subsidiary, Schmitt Measurement Systems, Inc. ("SMS"), a Montana corporation, the Company also designs, manufactures and markets precision laser measurement systems.

The Company was incorporated under the laws of British Columbia, Canada in 1984. The Company name was changed to Schmitt Industries Inc. in 1987. In 1996, the Company was "continued" from British Columbia to the state of Wyoming and then merged into its wholly owned subsidiary, Schmitt Industries, Inc., an Oregon corporation; Schmitt Industries, Inc. was the surviving entity.

The Company acquired its original balancing equipment technology pursuant to a series of agreements from 1987 through 1991. The patented technology has been substantially enhanced and advanced by the Company in the past decade.

In 1995, the Company acquired all the outstanding shares of TMA Technologies Inc. ("TMA"), a designer, assembler and marketer of innovative industrial measurement systems based on laser light scatter technologies. As part of the purchase, the Company agreed to make royalty payments to TMA's shareholders of 5% on sales of TMA products and future Company products that utilize TMA's technologies, hardware, software and existing patents, subject to a maximum royalty of $6 million. Shortly after the acquisition, TMA began operations in Portland and subsequently changed its name to Schmitt Measurement Systems, Inc. ("SMS")

In 1996, the Company formed a wholly owned subsidiary, Schmitt Europe, Ltd. ("SEL"), under the laws of Great Britain to market and sell the Company's products in Great Britain.

In 1996, the Company purchased all the assets of the grinding wheel balancer division of Hofmann Machinenbau GmbH of Germany. The Company operates this business as Schmitt Hofmann Systems GmbH ("SHS"), a wholly owned subsidiary of the Company.

The Company's executive offices are located at 2765 N.W. Nicolai Street, Portland, Oregon 97210, and its telephone number is (503) 227-7908.

BALANCING PRODUCTS

The Company's principal product is the Schmitt Dynamic Balance System (the "SBS System"). It consists of a computer control unit, sensor, spindle-mounting adapter, and balance head. It was designed to be an inexpensive, yet highly accurate, permanent installation on grinding machines. Today, the SBS System is beginning to be evaluated by manufacturers for additional applications including large electric motors, industrial fans, industrial brushing devices, turbines and similar devices.

The SBS System is fully automated and consequently the user does not have to pre-balance such devices as grinding wheels. This reduces the setup time of such operations and ensures a smoother and more efficient operation. Operating on a principle of mass compensation for wheel imbalance, the balance head contains two movable eccentric weights, each of which is driven by electric motors through a precision gear train. These weights can be repositioned to offset any imbalance in a grinding wheel or other

application. Imbalance or vibration is picked up by the sensor that feeds a signal to a controller that filters the signal by revolutions per minute. The controller then drives the two balance head weights in the direction that reduces the amplitude of the vibration signal. When the weights are positioned so the lowest vibration level is reached, the balance cycle is complete.

Notable features of the SBS System include its ability to fit almost all machines, ease of installation, compact and modular construction, ability to balance a wheel while on a machine, elimination of wheel vibration, automatic monitoring of balancing, display in both English and metric systems, instrument grade calibration, short balance process, measurement of both displacement and/or velocity, and minimal user maintenance.

Benefits to the system user include improved quality of finished parts, ease of product adaptation, minimal downtime, complete and ready installation, elimination of need for static balancing, longer life for wheels, dressings, diamonds and spindle bearings, the ability to balance within 0.02 microns and its adaptability to all types of machines.

The precision grinding industry has a worldwide presence and is established in all industrialized countries. In each major industrialized country there are three major market segments: machine tool builders, rebuilders and grinding machine users.

The first major market segment consists of machine tool builders who actually design and manufacture a variety of cylindrical, surface and specialty application grinding machines that are sold at home and also exported to foreign markets. SBS System products are distributed to a variety of world markets through OEM (original equipment manufacturer) accounts, where a special pricing (20%) discount is offered to the machine builder if the designer incorporates the SBS System into its machine.

Examples of some of well-known worldwide machine tool builders who have offered and/or installed the SBS System include ANCA (Australia), Bryant Grinders Corporation (U.S.), Blohm Incorporated (U.S.), Blohm GmbH (Germany), Capco Machinery (U.S.), Cincinnati Milacron (U.S.), Ecotech/SMTW (China/U.S.), Gold Crown Machinery (U.S.), Gleason Works (U.S.), Litton IAS/Landis Grinding (U.S.), Micron Machinery Limited (Japan/U.S.), Normac Incorporated (U.S.), NTC Toyama America (U.S./Japan), Okomoto (Japan), Okuma Machine (Japan), Royal Master Grinders (U.S.), Shigiya Machine (Japan), Sumitomo Heavy Industry (Japan), CETOS Hostivar (Czech Republic), TOS Holice (Czech Republic), Toyoda Machine (Japan) and Weldon Machine Tool (U.S.).

One successful marketing channel to tool builders is grinding machine users. Those customers use the SBS System and enjoy the benefits from that product. When they purchase new systems from OEM's, they often request that SBS products be included with the new equipment.

The second major market segment consists of machine tool rebuilders found in all industrial nations who develop their business with users by offering to completely update and refurbish older machine tools. These rebuilders typically tear the old machine apart and install new bearings, electronics, and advanced features, such as the Schmitt Dynamic Balancing System. The Company currently sells its products directly to all major machine rebuilders in the U.S. and to some countries in Western Europe.

Grinding machine users in industrialized countries are the third major market segment. Users become aware of the SBS System through trade shows, trade magazine advertising, distributors, field representatives, referrals and new machine suppliers.

Precision grinding is increasing as a worldwide method of material removal and processing. Therefore, the Company believes there may be an increase in market growth and an increase in the need for automatic balancers. Precision grinding is necessary in all major manufacturing areas such as the automotive industry (camshafts, crankshafts, valves), bearings (roller and tapered types), ceramics (precision shaping), electric motors (shafts), pumps (shafts and turbines), aircraft (engine parts), and general manufacturing.

The Company's business is conducted with many customers located throughout the world. Examples of some of the more well known of these include Black & Decker, Briggs and Stratton, Caterpillar Inc., Daewoo International Corp., Eaton Corporation, Ford Motor Company, General Electric Corp., General Motors, Ingersoll Rand, Sumitomo Heavy Industries, Texas Instruments, The Timken Company, Torrington, TRW Automotive Components and Westinghouse Electric Corp.

The acquisition of SHS added additional balancer designs to the Company's worldwide product line. The SHS internal spindle balancers and ring balancers add to the total balancer package available from the Company. These proven designs, along with the original fluid-based balancer, allow Schmitt to broaden its machine applications.

In Fiscal 1997, 1998 and 1999, net sales of the Company's balancing products totaled $6,151,473, $7,532,112 and $7,377,879, respectively. Net sales of balancing products accounted for 58% of the Company's revenue in Fiscal 1997, 71% in Fiscal 1998 and 93% in Fiscal 1999. See Note 9 to Consolidated Financial Statements.

COMPETITION. Management believes the SBS System is the only fully automatic balancing system marketed in the world. All other competitive balancing products require special setup and training or calibration to the specific machine. The Company believes the SBS System is currently the only balancing product on the market that fits all machines with wheel sizes from 6 to 48 inches in diameter and a spindle rpm of 500 through 7,500.

Competitive products include European manufacturers building water balancers and electromechanical balancers similar to the SBS System. Water balancers are currently priced about 1.5 times the level of the SBS System because of expensive plumbing and water chambers machined into the wheel hub. The machines are disassembled and parts remachined or replaced within the spindle assembly, a process that takes from one to two days. The system is "tuned" or "calibrated" to the machine by a factory service technician. Although water systems are unable to balance at low rpm, they work at mid- and high-speeds when properly monitored by regularly cleaning filters and checking clearance of water jets. This technology is the oldest in the market and is employed in the SHS-installed systems. After the acquisition of SHS in 1996, the Company considered European electromechanical balancers as its major competition due to their established base in Europe.

Several European companies located primarily in Switzerland, Germany, Spain and Italy produce electromechanical balancers similar to the SBS System. These European balancers have electronic deficiencies that render them less effective in solving essential balancing requirements. They cannot achieve the consistent low balance levels obtained by the SBS System and cannot operate effectively at 500 rpm (low speed) or at 7,500 rpm (high speed). In addition, these balancers have inferior brush and cable assemblies that cause down time and high maintenance. None of these companies currently can compete effectively with the Company in providing mounting adapters for all grinding machines.

The SBS System list price is $7,995 worldwide. Water balancers produced by German companies other than SHS are priced at $11,000 to $15,000, and electromechanical systems are priced at $8,000 to

$10,000 worldwide. Management market surveys indicate customers perceive the value of an automatic balancer to be approximately $8,000; therefore, Company pricing is geared to obtaining a dominant market position and meeting competitive supplier prices. The market strategy is to establish the SBS System as the dominant product with the best quality, reliability and performance and superior economic value.

SCHMITT MEASUREMENT SYSTEMS, INC.

SMS manufactures and markets a line of laser-based, precision measurement systems. In addition, SMS operates a precision light scatter measurement laboratory utilized by third-party equipment manufacturers and others.

Light scatter technology involves using lasers, optics and detectors to throw a beam of light on a material sample and record its reflection/transmission. Analysis of light scatter information can determine material characteristics such as surface roughness and defects, without introducing contaminants and causing changes to the tested material.

The principal products of SMS are laser-based measurement products and technology applicable to both industrial and military markets. Historically, TMA (now SMS) did not pursue industrial markets but instead concentrated on military markets. The Company believes this strategy was a significant contributing factor in the failure of TMA to achieve profitable operations.

The Company has used the patents, patent applications, trademarks and other proprietary technology acquired with TMA to successfully refocus the marketing efforts into industrial markets, including electronics, computer disk manufacturers and flat-panel display manufacturers.

In Fiscal 1997, 1998 and 1999, net sales of SMS products totaled $4,390,499, $3,093,972 and $579,844, respectively. Net sales of SMS products accounted for 42% of the Company's revenue in Fiscal 1997, 29% in Fiscal 1998 and 7% in Fiscal 1999. See Note 9 to Consolidated Financial Statements.

SMS operates three product lines: laser-based light-scatter measurement products, a light-scatter measurement laboratory and other laser alignment products.

The measurement products use proprietary laser light scatter technology to perform non-contact surface measurement tests that quantify surface micro-roughness in a rapid, accurate, repeatable and non-destructive manner. Products are sold to manufacturers of disk drives and silicon wafers, both industries with fabrication processes that require precise and reliable measurements.

Computer hard disks require exact manufacturing control and a narrow tolerance band for acceptable roughness. The read/write head of the disk drive flies over the surface on a cushion of air generated when the rough surface of the rotating disk pulls air under the head. If the surface is too smooth, the head may stick or bind to the disk. If it is too rough, the head will fly too far from the disk surface, causing a reduction in data density or storage capacity. The TMS and DTM product series meet the challenges of disk drive manufacturers.

The original TMS-2000 (Texture Measurement System) product revolutionized disk-manufacturing technology by providing the fastest, most accurate, non-contact texture measurement system in the world. It is currently being used by most major disk drive manufacturers and provides fast, accurate, repeatable microroughness measurements and quadruples production throughput when compared to other testing devices.

The DTM 2000 (Dual Texture Measurement System) is the fastest, most accurate, non-contact automated texture measurement system in the world. This product provides affordable 100% inspection and is currently being used by most major manufacturers of computer disk drives. The advanced laser-based system is ideally suited for testing in production or quality control applications. An automated conveyor system moves the disks on a cassette. Each disk is automatically raised from the cassette, scanned simultaneously on both sides by twin lasers and returned to the cassette. Testing speeds are compatible with most in-line production processes. Customers of the DTM and TMS series include Seagate Substrates, HMT Technology Corporation, Western Digital and Komag, Inc.

The capabilities of these products were enhanced significantly in Fiscal 1999 with the development and introduction of the "RC" series. This product uses light scatter technology to simultaneously measure roughness of the disk surface in two directions. The read/write head travels over the disk in two ways, radially when moving to another disk sector and circumferentially when processing information on the disk. With emerging disk technology, two separate roughness measurements averaging below one angstrom are required so the head can operate correctly. This measurement method was not possible until developed by Schmitt and is not possible through any other measurement means that are cost effective. Surface roughness can now be measured to levels below 0.5 Angstroms (the point of a needle is 1 million angstroms in diameter).

The TMS-2000W and TMS-3000W (Texture Measurement Systems) are the SMS products that provide fast, accurate, repeatable measurements for manufactures of silicon wafers, computer chips and memory devices. The system provides measurements to a few hundredths of an angstrom, a level unachievable by other testing devices. Silicon wafers are carefully cut and polished to provide the base upon which a computer or memory chip is produced. Chip manufacturing is extremely dependent on the beginning surface roughness of the wafer as all silicon wafers exhibit a microscopic level of surface roughness, stemming from chemical deposition, grinding, polishing, etching, or any number of other production techniques. This industry demands manufacturing precision to increase performance and capacity and the TMS-2000W and TMS-3000W help achieve these goals. This system also provides a way for SMS customers to quantify and control its manufacturing process.

SMS provides a highly advanced, extremely precise measurement services laboratory to a wide variety of industrial and commercial businesses, using advanced laser light scatter technology. The laboratory uses three SMS CASI Scatterometers for measuring surface roughness. The true value of the laboratory is not only its extremely precise measurement capability but also the test item is not altered, touched or destroyed. Thus, the laboratory is widely used by the semiconductor and computer hard disk industries, as well as manufacturers of critical optical components in aerospace and defense systems. Customers of the laboratory have included Aerojet, AT&T Bell Labs, Eastman Kodak, General Electric, IBM, NASA and dozens of other industrial companies, universities and government agencies.

The CASI Scatterometers are angle-resolved BRDF measurement instruments providing customers with precise roughness measurements of optical surfaces, diffuse materials, semiconductor wafers, magnetic storage media, precision-machined surfaces, as well as surfaces affecting the cosmetic appearance of consumer products. A Scatterometer uses 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.

The sample is mounted on stages capable of moving bidirectionally and/or in rotation. The detector sweeps around the sample in the incident plane measuring scattered and specular light. During the scan, the computer controls gain, filter and aperture changes through user-defined parameters. The instrument

background is measured separately and can be compared with the sample data. Results print on the HP PaintJet printer as viewgraphs or publication-ready figures.

The laboratory generated approximately 2% of SMS's total revenue during Fiscal 1997, 3% during Fiscal 1998 and 20% during Fiscal 1999. Total revenue for this business is expected to rise modestly in the future but to always represent a small percentage of SMS's business. Use of the laboratory leads to orders for SMS's laser-based light scatter measurement products by its customers and therefore represents one of the best marketing channel for SMS's current and future products. Existing products (such as the iScan and the Model 2002 alignment laser system) and products being developed in conjunction with the measurement services laboratory are being marketed to a variety of industrial customers.

The Scan System consists 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. The results are displayed and stored in system memory. The Scan 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 flat or curved surfaces under any lighting conditions.

The Auto-Collimating Alignment Laser System - Model 2002 is an extremely accurate laser alignment system. The incorporation of a solid-state laser diode provides increased beam stability and eliminates warm-up time. The unique TMA See-Thru target design completely eliminates beam displacement and power loss. The addition of an operator selectable auto-collimating feature provides one arc second accuracy over a large angular range. A microprocessor automates system configuration. A new bus interconnect reduces setup time and allows up to seven operator selectable targets, reducing time required to perform measurements. A complete Model 2002 system consists of an auto-collimating laser, power supply, digital display, See-Thru and end targets, carrying case and cable assemblies.

On April 23, 1998, the Company entered into a Technology Transfer Agreement with Centerline Engineering, Inc. and several individuals for the purchase of the rights to a non-contact gauging apparatus. The $100,000 purchase included the technology, the prototype and instruction manuals, technical information, and related patent applications. In Fiscal 1999, SMS developed the initial product utilizing that technology and installed the equipment at a beta-test site. Introduction of the new product is expected to occur in Fiscal 2000.

BUSINESS AND MARKETING STRATEGY

The Company designs, assembles and markets all of its products. The Company's operations are divided into a number of different areas. The Vice President of Operations directs the production organization, and is responsible for all assembly, purchasing and production engineering. The Product Marketing Division is responsible for the sale of SBS System products and is managed by the President/CEO and four Marketing Managers. Three of the Marketing Managers are responsible for domestic sales while the fourth is responsible for sales in Mainland China, Japan and Korea. The President/CEO is responsible for sales in both eastern and western Europe and also oversees the efforts of the four Marketing Managers. The technical services division is responsible for providing technical support to customers and is managed by the Vice President of Operations. Finally, there is a research and development group supervised directly by the President/CEO and the Vice President of Operations.

The Company markets and sells the SBS System in a variety of ways. First, the Company uses the conventional channels provided by independent manufacturer's representatives and distributors. There are

currently 25 individuals and/or organizations in the United States acting in one of these capacities. Independent sales agents are paid a 10% commission; distributors are sold products at a 15% discount.

Second, trade shows represent a significant amount of marketing/sales effort. These events are held throughout the world and have proven to be excellent sources of business. A Company representative, usually one of the marketing managers and/or the President/CEO, attends these events along with local Company representatives. These individuals operate a display booth featuring professional products, an SBS System demonstration stand and product and technical literature. Representatives from all facets of the market to which the Company directs its sales efforts attend these trade shows.

Third, original equipment manufacturers often include the SBS System on the machine tools they produce. Users thus purchase the SBS System concurrently with the machine tools. The SBS Systems are often installed by machine builders prior to displaying their own machine tools at various trade shows and these samples often become endorsements that prove beneficial to the Company's sales efforts.

In the United States, most products are shipped directly to customers from the Company's distribution center 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. Western European distribution to customers is handled by shipping the product directly from the Company's Portland headquarters to the European subsidiaries, who in turn sell the products to the end users.

Similar to the parent company, SMS uses a variety of methods to market and sell its products. First, a Marketing Manager who is under the direction of the President/CEO directs the overall marketing efforts. Second, the Company uses an independent manufacturer's representative to work with and service customers. That agent is paid a 5% commission on units he is responsible for selling. Third, trade shows represent a significant amount of marketing/sales effort. The President/CEO attends these events along with various Company representatives. These individuals operate a display booth featuring professional products, SMS product demonstrations and product and technical literature. Representatives from all facets of the market to which the Company directs its sales efforts attend these trade shows. Fourth, the Company had an Exclusive Distribution Agreement, with Sloan Technology, Inc. (dba Veeco Process Metrology), a subsidiary of Veeco Instruments, Inc. (NASDAQ : VECO). Under this agreement, Veeco was appointed the exclusive distributor for the promotion and sale of SMS products. Veeco was also to provide customers with after-sale services. This agreement was mutually terminated in December 1998. In fiscal 1999, approximately 2% of the Company's total revenue was attributable to sales made to Veeco. No customer accounted for more than 10% of the Company's total revenue in Fiscal 1999.

All SMS products are manufactured in the Portland, Oregon facility and shipped directly to customers around the world from that location.

The SBS System customer base consists of over 250 companies and the SMS customer base consists of approximately 200 companies, many of which are also purchasers of the Company's balancing products.

MANUFACTURING

The Company does not use any unique sources of supply or raw materials in its products for either SBS System balancing products or SMS measurement products. Essential electronic components used are available in large quantities from various suppliers. These electronic components are assembled into the SBS System and SMS electronic control units to meet 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. The Company believes several sources of supplies exist for all electronic components and assembly work used in its electronic control system. The Company's primary outside supplier of electronic assembly is Laughlin-Wilt Group, Inc. ("Laughlin-Wilt") of Beaverton, Oregon, a custom supplier of assembled electronic products for several Pacific Northwest companies. In the event of supply problems, the Company believes that two or three alternatives could be developed within 30 days to supplement or replace Laughlin-Wilt.

Mechanical parts for the Company's SBS System and SMS products are produced to the customers' drawings and specifications by local high quality CNC machine shops. Several such CNC machine shops exist in the local area, and the Company is not dependent on any one supplier of mechanical components. Principal suppliers of components for the Company's products include MacKay Manufacturing of Spokane, Washington; OEM Manufacturing of Corvallis, Oregon; Eagle Industries of Newberg, Oregon; and Forest City Gear of Roscoe, Illinois.

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.

In November 1996, the Company's Quality Control Program received full ISO-9001 certification.

PROPRIETARY TECHNOLOGY

The Company's success depends in part on its proprietary technology, which the Company attempts to protect through patents, copyrights, trademarks, trade secrets and other measures.

The Company has U.S. patents covering both its SBS and SMS products, processes and methods which the Company believes provide it with a competitive advantage. The Company has a policy of seeking patents when appropriate on inventions concerning new products and improvements as part of its ongoing research, development and manufacturing activities. While patents provide certain legal rights of enforceability, there can be no assurance that the historical legal standards surrounding questions of validity and enforceability will continue to be applied or that current defenses as 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, whether patents will issue or the extent to which the Company may inadvertently infringe upon patents granted to others.

"SBS" and "SMS" are registered trademarks and are affixed to all products and literature created in the Company's balancer and measurement product lines, respectively. The Company also has registered trademarks covering various SMS systems and instruments.

The Company manufactures its SBS 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 marks, 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

Prior to Fiscal 1996, research and development activities of the Company were focused on the enhancement of the existing product lines for balancers and on development work toward the ring balancer product. Since its acquisition of TMA, the Company has expended significant efforts evaluating existing and potential new products for the light-scatter precision measurement market.

In Fiscal 1997, the Company began an aggressive research and development program to expand the product lines and capabilities with the goal to enter new market areas and enhance products in existing market areas. The goal was to reduce reliance the Company had on historic market segments. During Fiscal 1999, the Company continued to develop new balancing and laser measurement products.

The new SB-4500 unit controls balancing in applications with speeds ranging from 300 to 30,000 rpm compared to a range of 500 to 10,000 rpm with the prior Schmitt product. Vibrations are now measured down to 0.02 microns or 0.75 millionths of an inch, a ten-fold performance improvement over the prior control unit. Finally, customers can balance their grinding machines faster, reducing costly down time and increasing factory throughput. The multi-function unit now provides the versatility to control several activities including Schmitt's mechanical and fluid based balancers and the new AEMS (Acoustical Emission Monitoring System) product. This new generation of computer control will allow the future addition of new Schmitt products through the insertion of electronic control cards in any of the four control slots located in the SB-4500.

Schmitt developed the AEMS (Acoustical Emissions Monitoring System) product to meet the needs of its grinding customers. The product is added to the SB-4500 balance control unit via insertion of an electronic control card. It monitors the dressing and grinding process of the customer by direct measurement of machine-generated acoustic signals. By monitoring the high frequency sound signal generated by contact between the wheel and work piece, the system automatically determines when wheel contact is made. Users can eliminate the "gap" time from their grinding process and also automatically detect the beginning of a wheel "crash" and immediately signal the grinder to stop before real damage occurs. Customers can also use the acoustic information made available by the AEMS system to monitor the quality and timing of wheel contact with either the work part or the wheel dresser, thereby further improving the whole process. The benefits of the AEMS "gap and crash" product to the customer include time savings from quick and easy setups, improved dressing and grinding process, and elimination of expensive part and machine damage.

The grinding industry is moving rapidly toward higher speed grinding applications and the Hydrokompenser system has been redesigned to appeal to these environments (defined as those with grinding speeds up to 20,000 rpm). Until now, the industry has not had a product that could be used in the emerging high speed grinding environments. This industry segment requires the most precise grinding and therefore control that only Schmitt products can provide. Now controlled by the SB-4500 computer control unit, the Hydrokompenser possesses the same precise and exacting performance standards required by the high speed grinding industry

Disk drive media of the future will have greater storage capacity on the same size disk. Increasing the density of the information stored on the disk is the main method to increase capacity. To do so, the roughness of the disk media must be reduced to levels below ten angstroms, the current production standard. To assure those levels are reached and to avoid significant postproduction rejects, the customer may test 100% of all disks. Schmitt Measurement products continue to provide manufacturers with that capability and those tools were improved dramatically during the most recent fiscal year. The TMS-2000RC and DTM-2000RC are examples of technology enhancing or complementing existing products.

Companies that grind the production rolls used in such industries such as steel, brass, copper, printing and paper face a long, slow manual process to assure these rolls are ground to the dimensions and smoothness required before they can be used in their factory. Problems experienced include the difficulty of obtaining proper alignment of rolls during grinding, the time-consuming measurement of roll geometry and surface finish during grinding, the need for expensive periodic re-grinding of used rolls and the resulting costly factory down time. The industry has been seeking a solution to these problems that would automate the process and allow grinding of rolls to an increased level of precision

The solution to the dilemma faced by the roll grinding industry is to use Schmitt patented laser light scatter technology to speed up the process and reduce costs. The computer controlled system measures rolls to exact dimensions that are established by the customer. Evaluated are the alignment of the roll in the grinder, the diameter of the roll compared to established levels and the mircroroughness of the surface. A process that has been totally manual has now become fully automated and much more accurate. This new laser-based technology is scheduled to be introduced in the second quarter of Fiscal 2000. This new Schmitt system results in the lowest possible measurement costs to the customer yet produces by far the highest quality product, together with improved documentation. User costs decline because this non-contact measuring process is designed to allow quicker setups of the roll grinder and in-process gauging (rather than stopping the process to make measurements). The result is increased grinding throughput as the yield is increased due to these production efficiencies. Rolls can be inspected on a 100% basis rather than the current random test method. The product is currently under testing at a beta test site where several companies within the industry have seen it and are interested in learning more about the product.

During Fiscal 1997, 1998 and 1999, the Company's research and development expense totaled $205,800, $379,798 and $462,136 respectively.

INTERNATIONAL SALES

The Company's sales in the last three fiscal years have been generated from the following geographic areas:

	North America	Europe	Asia
Fiscal 1999	$4,901,460	$2,798,471	$257,792
Fiscal 1998	8,006,428	2,488,344	131,312
Fiscal 1997	8,664,819	1,601,359	275,794

BACKLOG

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

EMPLOYEES

As of July 16, 1999, the Company employed 53 individuals worldwide on a full-time basis. There were no regular part-time employees. None of the

Company's employees is covered by a collective bargaining agreement.

ITEM 2. PROPERTIES

The Company's design and assembly facilities and executive offices are located in a 7,500-square foot building in Portland, Oregon owned by the Company; a 33,000-square foot facility, located across the street from the executive offices and also owned by the Company, houses SMS's operations. Schmitt Europe Ltd. occupies a 1,893-square foot facility in Coventry, England pursuant to a five-year lease beginning February 1, 1997 with a basic monthly rent of L1,708 (approximately $2,737 as of July 16, 1999). SHS occupies a 5,194-square foot facility in Alsbach, Germany pursuant to a five-year lease beginning February 1, 1997 with a basic monthly rent of DM 5,442 (approximately $2,904 as of July 16, 1999). The Company believes its facilities are adequate to meet its currently foreseeable needs.

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the security holders of the Company during the fourth quarter ended May 31, 1999.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Since May 5, 1997, the Company's Common Stock has been traded on the Nasdaq National Market; prior to that it was traded on the Nasdaq-Small Cap Market. The Common Stock is traded under the symbol "SMIT."

The following tables set forth the high and low sales prices of the Company's Common Stock as reported on the Nasdaq National Market for the periods indicated.

YEAR ENDED MAY 31, 1998	HIGH	LOW
First Quarter	$9.75	$7.50
Second Quarter	$12.00	$8.00
Third Quarter	$10.13	$7.38
Fourth Quarter	$8.13	$5.69

YEAR ENDED MAY 31, 1999	HIGH	LOW
First Quarter	$6.38	$3.88
Second Quarter	$5.00	$3.13
Third Quarter	$4.38	$3.00
Fourth Quarter	$4.00	$1.94

As of July 16, 1999, there were 8,184,889 shares of Common Stock outstanding held by approximately 130 holders of record. The number of holders does not include individual participants in security position listings; the Company believes that there are more than 2,500 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.

ITEM 6. SELECTED FINANCIAL DATA

The information required by this Item is included in the Company's Annual Report to Shareholders for the fiscal year ended May 31, 1999 ("Annual Report") under the heading "Selected Financial Data" and is incorporated herein by reference.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information required by this Item is included in the Annual Report under the heading "Management's Discussion and Analysis" and is incorporated herein by reference.

ITEM 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

INTEREST RATE RISK

The Company does not have any derivative financial instruments as of May 31, 1999. However, the Company is exposed to interest rate risk. The Company employs established policies and procedures to manage its exposure to changes in the market risk of its marketable securities.

The Company's interest income and expense are most sensitive to changes in the general level of U.S. and European interest rates. In this regard, changes in U.S. and European interest rates affect the interest earned on the Company's cash equivalents and marketable securities as well as interest paid on debt.

The Company has lines of credit and other debt whose interest rates are based on various published prime rates that may fluctuate over time based on economic changes in the environment. The Company is subject to interest rate risk and could be subject to increased interest payments if market interest rates fluctuate. The Company does not expect any change in the interest rates to have a material adverse effect on the Company's results from operations.

FOREIGN CURRENCY RISK

The Company operates subsidiaries in the United Kingdom and Germany. The Company's business and financial condition is, therefore, sensitive to currency exchange rates or any other restrictions imposed on their currencies. To date, the foreign currency exchange rates have not significantly

impacted the Company's profitability.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements and other information required by this Item are included in the Annual Report and are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

In July 1997, the Company replaced its independent accountant, Moss Adams LLP, with PricewaterhouseCoopers LLP. The Audit Committee of the Company's Board of Directors made this decision.

Moss Adams LLP's report for the fiscal year ended May 31, 1997 did not contain an adverse opinion or disclaimer of opinion, nor was it qualified or modified as to uncertainty, audit scope or accounting principles. During Fiscal 1997 and until Moss Adams LLP's dismissal, there were no disagreements with Moss Adams LLP on any matter of accounting principles or practices, financial statement disclosure or auditing scope of procedure, which disagreements, if not resolved to the satisfaction of Moss Adams LLP, would have caused it to make reference to the subject matter of the disagreements in connection with its report.

PART III

Certain information required by Part III is included in the Company's definitive Proxy Statement for its 1999 Annual Meeting of Shareholders ("Proxy Statement") and is incorporated herein by reference. The Proxy Statement will be filed pursuant to Regulation 14A of the Securities Exchange Act of 1934 not later than 120 days after the end of the fiscal year covered by this Report.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this item is included in the Proxy Statement under the heading "Election of Directors" and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is included in the Proxy Statement under the heading "Executive Compensation" and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this item is included in the Proxy Statement under the heading "Principal Shareholders" and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is included in the definitive Proxy Statement under the heading "Certain Transactions" and is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents filed as part of this report:

1. REPORT OF INDEPENDENT ACCOUNTANTS:

To the Board of Directors and Shareholders of Schmitt Industries, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows and of changes in stockholders' equity present fairly, in all material respects, the financial position of Schmitt Industries, Inc. and its subsidiaries at May 31, 1999 and 1998, and the results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP
Portland, Oregon
July 13, 1999

2. INDEPENDENT AUDITOR'S REPORT:

To the Board of Directors and Stockholders of Schmitt

Industries, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheet of Schmitt Industries, Inc. and Subsidiaries as of May 31, 1997, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall

financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Schmitt Industries, Inc. and Subsidiaries as of May 31, 1997, and the results of their operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

Moss Adams LLP
Portland, Oregon
July 10, 1997

3. FINANCIAL STATEMENTS:

The following financial statements required by this Item are included in the Company's Annual Report to Shareholders for the fiscal year ended May 31, 1999 and are incorporated by reference herein:

4. FINANCIAL STATEMENT SCHEDULES:

All financial statement schedules are omitted either because they are not applicable, not required, or the required information is included in the financial statements or notes thereto.

(b) Reports on Form 8-K: None.

SIGNATURES

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

SCHMITT INDUSTRIES, INC.

By: /s/ Wayne A. Case

Wayne A. Case
CHAIRMAN OF THE BOARD, PRESIDENT
AND CHIEF EXECUTIVE OFFICER

Date: August 30, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on August 30, 1999.

SIGNATURE	TITLE
/s/ Wayne A. Case Wayne A. Case	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
/s/ Robert C. Thompson Robert C. Thompson	Chief Financial Officer/Treasurer (Principal Financial and Accounting Officer)
/s/ David L. Dotlich David L. Dotlich	Director
/s/ David M. Hudson David M. Hudson	Director
/s/ Trevor Nelson Trevor Nelson	Director
/s/ Dennis T. Pixton Dennis T. Pixton	Director
/s/ John A. Rupp John A. Rupp	Director

INDEX TO EXHIBITS

EXHIBITS	DESCRIPTION

3(i)	Second Restated Articles of Incorporation of Schmitt Industries, Inc. (the "Company"). Incorporated by reference to Exhibit 3(i) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1998..
3(ii)	Second Restated Bylaws of the Company Incorporated by reference to Exhibit 3(ii) to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1998.................
10.1	Schmitt Industries, Inc. Amended & Restated Stock Option Plan. Incorporated by reference to Exhibit 10.1 to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1998..
10.2	Agreement dated April 21, 1995 between TMA Technologies, Inc. and the Company. Incorporated by reference to Exhibit 10.2 to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1996..
10.3	Exclusive Distribution Agreement dated February 23, 1998 between Sloan Technology Inc. and the Company. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended February 28, 1998. (Confidential treatment has been granted for certain portions of this Agreement; these confidential portions have been filed separately with the Securities and Exchange Commission.)..............................
10.4	Sales Contract dated November 19, 1996 between Herr Dirk Pfeil, receiver of Hofmann Machinenbau GmbH, and Schmitt Hofmann Systems GmbH. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended February 28, 1997..
10.5	Technology Transfer Agreement dated April 23, 1998 between Centerline Engineering, Inc. and the Company. Incorporated by reference to Exhibit 10.5 to the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 1998...
*13.1	Annual Report to Shareholders of Schmitt Industries, Inc. for fiscal year ended May 31, 1999
*21.1	Subsidiaries of Schmitt Industries, Inc..
*23.1	Consent of PricewaterhouseCoopers LLP..
*23.2	Consent of Moss Adams LLP..
*27.1	Financial Data Schedule..

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* Filed herewith

CONSOLIDATED BALANCE SHEETS

For the years ended May 31, 1999 and 1998

	1999	1998
ASSETS		
CURRENT ASSETS		
Cash	$ 268,888	$ 1,127,076
Accounts receivable	1,423,611	1,197,951
Inventories	4,444,012	4,166,755
Prepaid expenses	75,454	120,466
Deferred tax asset	--	34,623
Income tax receivable	295,964	190,806
	6,507,929	6,837,677
PROPERTY AND EQUIPMENT		
Land	299,000	299,000
Buildings and improvements	1,194,664	1,190,920
Furniture, fixtures, and equipment	942,776	906,058
Vehicles	144,064	139,261
	2,580,504	2,535,239
Less accumulated depreciation and amortization	926,314	691,258
	1,654,190	1,843,981
OTHER ASSETS		
Long-term investments	2,135,000	--
Long-term deferred tax asset	898,628	837,560
Other assets	86,667	100,000
	3,120,295	937,560
TOTAL ASSETS	$ 11,282,414	$ 9,619,218
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 392,287	$ 681,524
Accrued royalties	10,535	55,335
Accrued commissions	105,080	131,154
Other accrued liabilities	175,133	63,076
Income taxes payable	12,819	--
	695,854	931,089
COMMITMENTS AND CONTINGENCIES (NOTE 8)	--	--
STOCKHOLDERS' EQUITY		
Common stock, no par value, 20,000,000 shares authorized, 8,184,889 and 7,099,139 shares issued and outstanding at May 31, 1999 and 1998, respectively	7,284,445	5,072,634
Accumulated other comprehensive income (loss)	(201,781)	(147,708)
Retained earnings	3,503,896	3,763,203
	10,586,560	8,688,129
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 11,282,414	$ 9,619,218

CONSOLIDATED STATEMENTS OF OPERATIONS

For the years ended May 31, 1999, 1998 and 1997

	1999	1998	1997
Net sales	$ 7,957,723	$ 10,626,084	$ 10,541,972
Cost of sales	4,145,280	4,632,485	3,875,790
Gross profit	3,812,443	5,993,599	6,666,182
Operating expenses:			
General, administrative and sales expense	3,841,155	4,275,059	4,164,271
Research and development expense	462,136	379,798	205,800
Total operating expenses	4,303,291	4,654,857	4,370,071
Operating (loss) income	(490,848)	1,338,742	2,296,111
Other income and expense:			
Interest expense	(22,736)	(42,231)	(16,273)
Interest income	24,364	44,581	25,007
Unrealized gain on trading securities	--	--	22,400
Miscellaneous income	93,946	259,924	25,430
Other income and expense	95,574	262,274	56,564
(Loss) income before provision for income taxes	(395,274)	1,601,016	2,352,675
(Benefit) provision for income taxes	(135,967)	350,901	627,947
Net (loss) income	$ (259,307)	$ 1,250,115	$ 1,724,728
Net (loss) income per common share, basic	$ (0.03)	$ 0.18	$ 0.25
Weighted average number of common shares, basic	7,591,699	7,091,269	7,031,449
Net (loss) income per common share, diluted	$ (0.03)	$ 0.17	$ 0.23
Weighted average number of common shares, diluted	7,591,699	7,456,172	7,561,744

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended May 31, 1999, 1998 and 1997

	1999	1998	1997
CASH FLOWS RELATING TO OPERATING ACTIVITIES			
Net (loss) income	$ (259,307)	$ 1,250,115	$ 1,724,728
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:			
Depreciation	294,513	347,228	264,440
Amortization	13,333	--	72,393
Unrealized gain on trading securities	--	--	(22,400)
Deferred taxes	(26,445)	(57,183)	198,426
(Increase) decrease in:			
Trading securities	--	168,000	--
Accounts receivable	(225,660)	1,527,561	(1,313,707)
Inventories	(277,257)	(1,686,935)	(235,556)
Prepaid expenses	45,012	(89,798)	(14,762)
Income taxes receivable	18,914	(190,806)	--
Other assets	--	(9,585)	(90,415)
Increase (decrease) in:			
Accounts payable	(289,237)	150,857	185,839
Accrued liabilities, royalties, and commissions	41,183	(57,246)	62,198
Income taxes payable	12,819	(44,809)	(226,186)
Net cash (used in) provided by operating activities	(652,132)	1,307,399	604,998

CASH FLOWS RELATING TO INVESTING ACTIVITIES			
Purchase of property and equipment	(119,380)	(514,283)	(461,168)
Proceeds from disposal of equipment	14,658	24,250	10,651
Acquisition of assets of Hofmann Maschinenbau GmbH	--	--	(496,000)
Net cash used in investing activities	(104,722)	(490,033)	(946,517)
CASH FLOWS RELATING TO FINANCING ACTIVITIES			
Repayment of long-term debt	--	(179,983)	(34,895)
Common stock repurchased	(47,261)	--	--
Exercise of stock options	--	96,469	409,106
Net cash (used in) provided by financing activities	(47,261)	(83,514)	374,211
Effect of foreign exchange translation on cash	(54,073)	(111,438)	(36,270)
(DECREASE) INCREASE IN CASH	(858,188)	622,414	(3,578)
CASH, beginning of year	1,127,076	504,662	508,240
CASH, end of year	$ 268,888	$ 1,127,076	$ 504,662
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid during the period for interest	$ 22,736	$ 42,231	$ 15,272
Cash paid during the period for income taxes	$ 6,800	$ 405,800	$ 450,871
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES			
Acquisition of long-term investment	$ 2,135,000	--	--
Reduction of goodwill	$ --	$ (155,438)	$ (215,973)
Income tax benefit of stock options exercised	$ 124,072	$ (23,754)	$ (444,793)

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

For the years ended May 31, 1999, 1998 and 1997

	Shares	Amount	Retained Earnings	Accumulated other Comprehensive Income (Loss)
BALANCE, MAY 31, 1996	6,918,139	$ 4,098,512	$ 788,360	$--
Stock options exercised	163,750	409,106	--	--
Income tax benefit from exercise of stock options	--	444,793	--	--
Net income	--	--	1,724,728	--
Cumulative foreign exchange translation adjustment	--	--	--	(36,270)
BALANCE, MAY 31, 1997	7,081,889	4,952,411	2,513,088	(36,270)
COMPREHENSIVE INCOME, YEAR ENDED MAY 31, 1997				
Stock options exercised	17,250	96,469	--	--
Income tax benefit from exercise of stock options	--	23,754	--	--
Net income	--	--	1,250,115	--
Cumulative foreign exchange translation adjustment	--	--	--	(111,438)
BALANCE, MAY 31, 1998	7,099,139	5,072,634	3,763,203	(147,708)
COMPREHENSIVE INCOME, YEAR ENDED MAY 31, 1998				
Stock options exercised	485,750	869,475	--	--
Income tax benefit from exercise of stock options	--	124,072	--	--
Notes received for stock options	--	(869,475)	--	--
Stock issued for long-term investment	610,000	2,135,000	--	--
Common shares repurchased	(10,000)	(47,261)	--	--
Net loss	--	--	(259,307)	--
Cumulative foreign exchange translation adjustment	--	--	--	(54,073)
BALANCE, MAY 31, 1999	8,184,889	$ 7,284,445	$ 3,503,896	$ (201,781)
COMPREHENSIVE (LOSS), YEAR ENDED MAY 31, 1999				

	Total	Total Comprehensive Income
BALANCE, MAY 31, 1996	$ 4,886,872	$ --
Stock options exercised	409,106	--
Income tax benefit from exercise of stock options	444,793	--
Net income	1,724,728	1,724,728
Cumulative foreign exchange translation adjustment	(36,270)	(36,270)
BALANCE, MAY 31, 1997	7,429,229	
COMPREHENSIVE INCOME, YEAR ENDED MAY 31, 1997		$ 1,688,458
Stock options exercised	96,469	
Income tax benefit from exercise of stock options	23,754	
Net income	1,250,115	1,250,115
Cumulative foreign exchange translation adjustment	(111,438)	(111,438)
BALANCE, MAY 31, 1998	8,688,129	
COMPREHENSIVE INCOME, YEAR ENDED MAY 31, 1998		$ 1,138,677
Stock options exercised	869,475	
Income tax benefit from exercise of stock options	124,072	
Notes received for stock options	(869,475)	
Stock issued for long-term investment	2,135,000	
Common shares repurchased	(47,261)	
Net loss	(259,307)	(259,307)
CUMULATIVE FOREIGN EXCHANGE TRANSLATION ADJUSTMENT	(54,073)	(54,073)
BALANCE, MAY 31, 1999	$ 10,586,560	
COMPREHENSIVE (LOSS), YEAR ENDED MAY 31, 1999................................		$ (313,380)

NOTE 1
ORGANIZATION AND NATURE OF OPERATIONS
Schmitt Industries, Inc. (the Company) is engaged in the design, assembly, marketing, and distribution of electronic and mechanical components for machine tool products and laser measurement systems worldwide. In June 1996, the Company established Schmitt Europe, Ltd. (SEL). In addition, in December 1996, the Company established Schmitt Hofmann Systems GmbH (SHS) which acquired certain assets of the grinding wheel balance division of Hofmann Maschinenbau GmbH.

NOTE 2
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION
The consolidated financial statements include those of the Company and its wholly-owned subsidiaries. The wholly owned subsidiaries are Schmitt Measurement Systems, Inc. (SMS), Schmitt Europe, Ltd. (SEL) and Schmitt Hofmann Systems, GmbH (SHS). All significant intercompany accounts and transactions have been eliminated in the preparation of the consolidated financial statements.

REVENUE RECOGNITION
Revenue from product sales is recognized upon shipment. Sales are reported net of applicable cash discounts and allowances for returns.

INVENTORIES
Inventory is valued at the lower of cost or market. Cost is determined on the average cost basis. As of May 31, 1999 and 1998, inventories consisted of raw materials ($2,292,389 and $2,502,310 respectively), work-in-process ($222,888

and $60,075 respectively), and finished goods ($1,928,735 and $1,604,370, respectively).

PROPERTY AND EQUIPMENT

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

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially expose the Company to concentration of credit risk are trade accounts receivable. Credit terms generally include a discount of 1-1/2% if the invoice is paid within ten days, with the net amount payable in 30 days. No allowance for doubtful accounts is considered necessary.

During the year ended May 31, 1999, the Company canceled a strategic partnership with an entity to distribute systems manufactured by Schmitt Measurement Systems, Inc. For the years ended May 31, 1999, 1998 and 1997, approximately 2%, 24% and 22% of consolidated sales respectively were made to this customer.

INCOME TAXES

Deferred tax assets and liabilities are recognized for the future tax consequences of differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

RESEARCH AND DEVELOPMENT COSTS

Research and development costs are charged to expense when incurred.

TRADING SECURITIES

Trading securities consist of common stock and are stated at fair value, which is estimated based on quoted market prices. Unrealized gains or losses are included in other income and expense. Total realized gain on trading securities during fiscal 1998 was approximately $186,000 and is included in other income. No trading securities were held at May 31, 1999 and 1998.

USE OF ESTIMATES

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

CONSOLIDATED STATEMENT OF CASH FLOWS

The Company considers short-term investments that are highly liquid, readily convertible into cash and have original maturities of less than three months to be cash equivalents for purposes of the cash flows statement.

STOCK-BASED COMPENSATION

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," (FAS 123) encourages, but does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," (APB 25). Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock.

FOREIGN CURRENCY TRANSLATION

Financial statements for the Company's subsidiaries outside the United States are translated into U.S. dollars at year-end exchange rates for assets and liabilities and weighted average exchange rates for income and expenses. The resulting translation adjustments are recorded in a separate component of stockholders' equity titled "Accumulated Other Comprehensive Income (Loss)."

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of financial instruments approximate their fair values at May 31, 1999.

EARNINGS PER SHARE

Basic (loss) earnings per share is computed using the weighted average number of shares outstanding. Diluted (loss) earnings per share is computed using the weighted average number of shares outstanding, adjusted for the incremental shares attributed to outstanding options to purchase common stock. Using the treasury stock method as required by FAS 128, incremental shares of 364,903 and 530,295 in 1998 and 1997, respectively, were used in the calculation of diluted earnings per share. In fiscal 1999, 130,245 incremental shares were excluded from the diluted loss per share calculation as their effect was anti-dilutive.

NOTE 3
COMPANY ACQUISITIONS
On December 2, 1996, the Company purchased the inventories ($462,933) and equipment ($33,067) of the grinding wheel balancer division of Hofmann Maschinenbau GmbH for $496,000 and subsequently established Schmitt Hofmann Systems, GmbH (see Note 1). The results of SHS are included in the accompanying consolidated financial statements since the date of acquisition.

NOTE 4
LONG-TERM INVESTMENTS
In December 1998, the Company issued 610,000 shares of its common stock to acquire 13,757,155 shares or approximately 19.5% of the outstanding shares of Air Packaging Technologies, Inc. That company is engaged in the design, manufacture, marketing and sales of "Air Box" patented packaging systems used in the semiconductor, electronic, medical and dental markets worldwide. This investment is considered an "Available-for-sale securities" under Statement of Financial Accounting Standards No. 115. As required under that statement, all unrealized gains and losses are included in Accumulated Other Comprehensive Income (Loss) and reported as a separate component in Other Comprehensive Income (Loss) in Stockholders' Equity until realized. At May 31, 1999 there was no significant difference between market value and acquisition cost of $2,135,000.

NOTE 5
LINE OF CREDIT
The Company has a $1.5 million unsecured short-term line of credit agreement with a commercial bank. The line is guaranteed by the Company's wholly owned subsidiary, Schmitt Measurement Systems, Inc. Interest is payable at the bank's prime rate, or LIBOR +2.50%. The line of credit is renewable annually. No balance was outstanding as of May 31, 1999 or 1998.

NOTE 6
INCOME TAXES
The (benefit) provision for income taxes was as follows

Years ended May 31,	1999	1998	1997
Current	$(109,523)	$ 243,264	$ 826,368
Deferred	(26,444)	383,887	77,824
Decrease in valuation allowance	--	(276,250)	(276,245)
Total (benefit) provision for income taxes	$(135,967)	$ 350,901	$ 627,947

Deferred tax assets (liabilities) are comprised of the following components:

	1999	1998

Depreciation	$ 31,112	$ (29,861)
Net operating loss carryforwards	1,038,559	1,038,559
Inventory basis differences	--	34,623
Other asset capitalization	12,820	13,840
Other deferred assets	50,368	49,254
Gross deferred tax assets	1,101,747	1,136,276
Deferred tax asset valuation allowance	(234,231)	(234,231)
Net deferred tax asset	$ 898,628	$ 872,184

Through the acquisition of Schmitt Measurement Systems, Inc., the Company acquired approximately $5.5 million of U.S. federal net operating loss carryforwards. As of May 31, 1999, approximately $3 million of these net-operating losses remain and expire in the years 2007 through 2009. The deferred tax asset valuation allowance in fiscal years 1998 and 1999 is attributed to these net-operating losses.

The provision for income taxes differs from the amount of income taxes determined by applying the U.S. statutory federal tax rate to pre-tax income due to the following:

Years ended May 31,	1999	1998	1997
Statutory federal tax rate	(34.0%)	34.0%	34.0%
State taxes, net of federal benefit	(4.3)	3.2	4.4
Change in deferred tax valuation allowance	--	(27.5)	(20.9)
Reduction of goodwill associated with the acquisition of Schmitt Measurement Systems, Inc.	--	10.3	9.2
Other permanent differences	3.9	1.9	--
Effective tax rate	34.4%	21.9%	26.7%

NOTE 7

EMPLOYEE BENEFIT PLANS

The Company adopted the Schmitt Industries, Inc. 401(k) Profit Sharing Plan & Trust effective June 1, 1996. Employees must meet certain age and service requirements to be eligible. Participants may contribute up to 15% of their eligible compensation that is partially matched by the Company. The Company may further make either a profit sharing contribution or a discretionary contribution. Contributions made to this Plan during the years ended May 31, 1999 and 1998 were $86,899 and $135,335, respectively.

NOTE 8

COMMITMENTS AND CONTINGENCIES

In a transaction related to the acquisition of Schmitt Measurement Systems, Inc. (formerly TMA Technologies, Inc.), the Company established a royalty pool and vested each shareholder and debt holder in TMA Technologies, Inc. an interest in the royalty pool equal to the amount invested or loaned including interest payable through March 1995. The royalty pool will be funded at 5% of net sales (defined as gross sales less returns, allowances, and sales commissions) of Schmitt Measurement Systems, Inc.'s, products and future derivative products developed by Schmitt Industries, Inc., which utilize these technologies. As part of the royalty pool agreement, each former shareholder and debt holder released

TMA Technologies, Inc., for any claims with regard to the acquisition except their rights to future royalties. Long-term debt of $179,983 was fully paid to certain TMA Technologies, Inc., debt holders in fiscal year 1998.

NOTE 9

SEGMENTS OF BUSINESS

The Company operates principally in two segments of business: the manufacturing of mechanical components for the machine tool industry, and the manufacturing of laser measurement systems. The Company also operates in two principal geographic markets, U.S. and foreign. The segment which manufactures mechanical components for the machine tool industry reported gross sales of $8,223,308 for the year ended May 31, 1999, including inter-company sales of $845,429. This segment reported gross sales of $8,286,243 for the year ended May 31, 1998, including inter-company sales of $754,131 and gross sales of $6,488,348 for the year ended May 31, 1997 including intercompany sales of $336,875. The segment which manufactures laser measurement systems reported gross sales of $579,844 for the year ended May 31, 1999, with no inter-company sales. For fiscal year ended May 31, 1998, the measurement products segment reported gross sales of $3,108,769 including inter-company sales of $14,797, and gross sales of $4,390,499 for the year ended May 31, 1997 with no intercompany sales. Geographically, U.S. sales were $4,756,079, $7,873,148 and $8,728,082 for fiscal years ended May 31, 1999, 1998 and 1997 respectively. Foreign sales were $4,047,073, $3,521,864 and $2,150,765 for the same years, respectively. This includes inter-company sales of $845,429 for the year ended May 31, 1999, $768,928 for the year ended May 31, 1998 and $336,875 for the year ended May 31, 1997. For the years ended May 31, 1999, 1998 and 1997, respectively, export sales by the U.S. segment totaled $615,212, $344,100 and $612,704.

(Loss) income from operations for the years ended May 31, 1999, 1998 and 1997 for the mechanical components segment was $(263,965) $363,656, and $176,927, respectively. (Loss) income from operations for the years ended May 31, 1999, 1998 and 1997 of the laser measurement segment was $(226,883), $975,086, and $2,119,184, respectively. Consolidated (loss) income from operations includes an adjustment of $30,000 for the elimination of inter-company rent for the year ended May 31, 1999, $90,000 for the year ended May 31, 1998 and $30,000 for the year ended May 31, 1997. (Loss) income from operations for the U.S. segment was $(305,390), $1,423,502 and $2,393,558 respectively, for the years ended May 31, 1999, 1998 and 1997 and for the foreign segment, losses of $(185,458), $(84,760) and $(97,447) respectively, for the same years. Long-term assets at May 31, 1999 and 1998 were $4,097,803 and $2,004,753 for the mechanical components segment and $676,682 and $776,788 for the laser measurement segment. Long-term assets for the U.S. segment at May 31, 1999 were $4,654,796 and at May 31, 1998 were $2,634,909. Long-term assets for the foreign segment at May 31, 1999 were $119,689 and at May 31, 1998 were $146,632. Depreciation expense incurred during the years ended May 31, 1999, 1998 and 1997, by the mechanical components segment was $194,541, $206,335 and $156,374, respectively. The laser measurement segment incurred depreciation expense of $99,972, $140,893 and $108,066, for the years ended May 31, 1999, 1998 and 1997, respectively. Amortization expense incurred during the years ended May 31, 1999, 1998 and 1997 by the mechanical components segment was $13,333, $0, and $72,393 respectively. The laser measurement segment did not incur amortization expense for years 1999, 1998 and 1997. The U.S. segment incurred depreciation expense of $221,295, $276,102 and $226,755 during the years ended May 31, 1999, 1998 and 1997, respectively. The foreign segment incurred depreciation expense of $73,218, $71,126 and $37,705 respectively, for these same years. The U.S. segment incurred amortization expense of $13,333, $0, and $72,393 in fiscal years ended May 31, 1999, 1998 and 1997. The foreign segment has not incurred amortization expense. Capital expenditures for the years ended May 31, 1999 and 1998, were $117,884 and $238,016 by the mechanical components segment and $1,496 and $276,267 by the laser measurement segment, respectively. Capital expenditures for the years ended May 31, 1999 and 1998, were $60,079 and $466,801 by the U.S. segment and $59,301 and $47,482 by the foreign segment, respectively.

Income from operations represents sales less costs and operating expenses. In computing income from operations, all overhead expenses have been allocated to both industry segments, as they are an integral part of profit recognition for each segment. Identifiable assets by segment of business are those assets used in the Company's operations in each segment.

NOTE 10

STOCK OPTIONS
Prior to 1995, the Company granted stock options to officers and employees of the Company. Stock options for up to 10% of the outstanding shares were eligible for grant provided the stock options for any one individual did not exceed 5% of the issued and outstanding shares of common stock. The purchase price of the optioned shares was equal to not less than the average closing price of the Company's common stock for the ten trading days immediately preceding the grant date of the stock options. The maximum term of each stock option did not exceed five years and all options were vested and exercisable upon grant. All outstanding options were exercised in the fiscal year ended May 31, 1999. The officers/employees issued notes to the Company for the exercise price. The notes mature on or before December 2000 ($586,500) and January 2001 ($282,975), and carry interest at the rate of 6% per annum. These notes are reported as a reduction of stockholders equity.

The Board of Directors adopted a 1995 Stock Option Plan in December 1995 which Plan was amended in August 1996 and restated in August 1998. An option granted under the Amended and Restated Stock Option Plan may be either an incentive stock option (ISO), or a nonstatutory stock option (NSO). ISOs may be granted only to employees of the Company and are subject to certain limitations, in addition to restrictions applicable to all stock options under the Plan. Options not meeting these limitations will be treated as NSOs. The purchase price of ISOs is fair market value on the date of grant; the purchase price of NSOs may vary from fair market value. Vesting is generally on a cumulative basis over four years at 25% per year. The Company has 800,000 shares reserved for issuance under the stock option plan. The options expire in years 2006 through 2009.

The following summarizes the options outstanding as of May 31, 1999:

	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Combined Shares
Options outstanding, May 31, 1996	595,750	$ 1.79	232,500	$ 4.42	828,250
Options granted	--	--	117,500	$ 7.79	117,500
Options exercised	(110,000)	$ 1.79	(53,750)	$ 4.38	(163,750)
Options forfeited/cancelled	--	--	(14,000)	$ 4.38	(14,000)
Options outstanding, May 31, 1997	485,750	$ 1.79	282,250	$ 5.83	768,000
Options granted	--	--	174,000	$ 6.62	174,00
Options exercised	--	--	(15,750)	$ 5.71	(15,750)
Options forfeited/cancelled	--	--	(151,250)	$ 7.93	(151,250)
Options outstanding, May 31, 1998	485,750	$ 1.79	289,250	$ 5.22	775,000
Options granted	589,250	$ 3.24	589,250		
Options exercised	(485,750)	$ 1.79	--	--	(485,750)
Options forfeited/cancelled	--	--	(426,750)	$ 4.41	(426,750)
Options outstanding May 31, 1999	--		451,750	$ 3.02	451,750
Options vested at May 31, 1999	--		165,125	$ 3.00	165,125

For the 451,750 shares outstanding under the 1995 Stock Option Plan, the exercise price ranges from $3.00 to $3.30 per share and the remaining average contractual life was 7.8 years.

The Company has adopted the disclosure only provisions of SFAS 123. Accordingly, no compensation cost has been recognized for the stock option plans. Options were assumed to be exercised upon vesting for purposes of this valuation. Adjustments are made for options forfeited prior to vesting. For the years ended May 31, 1999, 1998 and 1997, total value of options granted was computed to be $1,275,098, $877,963 and $395,740, respectively, which would be amortized on a straight-line basis over the vesting period of the options. Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for the awards in 1999, 1998 and 1997, consistent with the provisions of SFAS 123, the Company's pro forma net (loss) income for the years ended May 31, 1999, 1998 and 1997, would be ($467,573), $889,944 and $1,436,760, respectively. Pro forma basic (loss) earnings per share for the years ended May 31, 1999, 1998 and 1997 would be ($.06), $.13 and $.20, respectively. Pro forma diluted (loss) earnings per share for the years ended May 31, 1999, 1998 and 1997 would be ($.06), $.12 and $.19, respectively.

The fair value of each option granted is estimated on the date of the grant using the Black-Scholes option and pricing model. The weighted average assumptions used for fiscal 1999, 1998 and 1997 were a risk-free interest rate of 5.5% for 1999 and 7.5% for 1998 and 1997, an expected dividend yield of 0% for all years, an expected life of 8, 8, and 10 years, respectively, and a volatility of 65%, 52% and 51%, respectively.

The effects of applying SFAS No. 123 in the proforma disclosure are not indicative of future amounts.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following information contains certain forward-looking statements that anticipate future trends or events. These statements are based on certain assumptions that may prove to be erroneous and are subject to certain risks including but not limited to the uncertainties of the Company's new product introductions, the risks of increased competetion and technological change in the Company's industry and other factors detailed in the Company's SEC filings. Accordingly, actual results may differ, possibly materially, from the predictions contained herein.

During fiscal 1999, the measurement markets the Company serves continued a downward trend started early in calendar year 1998. This drop was particularly evident in the disk drive and silicon wafer markets in Asia as well as the United States. As a result of these market changes, the Company's sales in fiscal 1999 declined significantly from fiscal 1998, with virtually the entire drop in sales of laser measurement products. The Company responded to this industry decline by seeking to develop new products and markets to reduce its historic reliance on these markets. Management expanded its research and development efforts so the Company could introduce new products for both the laser measurement and mechanical balancer markets in fiscal 1999 and 2000. The Company expects new products developed in 1999 and introduced in late fiscal 1999 and fiscal 2000 to increase revenues. In addition, the disk drive and silicon wafer markets are expected to improve which will also have an upward effect on sales. However, there can be no assurance that the Company will return to profitability with increased sales levels in future periods.

Sales outside the United States accounted for approximately 48% of the Company's revenues in 1999, 29% in 1998 and 23% in 1997. Some foreign customers purchase in their own country's currencies, thereby imposing on the Company a currency risk. All U.S. sales (52% of total sales in fiscal 1999) were in U.S. dollars and the remaining fiscal 1999 sales were in currencies other than U.S. dollars. To date, currency fluctuations have historically had little impact on revenue realization. However, significant variations in the value of the U.S. dollar, relative to currencies of countries in which the Company has significant competitors, can impact future sales. The Company does not engage in currency hedging. In addition, the longer payment cycles of international sales can have a negative impact on liquidity. The Company believes the dollar amount of international sales will continue to grow in future periods.

A substantial portion of the Company's revenue is derived from sales to end users through selling agents and directly to builders of machine tools. For fiscal 1999, sales to a single customer did not exceed 10% of total revenues, a change from prior years. In fiscal 1997 the Company entered into a strategic partnership with Veeco Instruments Inc. (NASDAQ:VECO) to act as the exclusive sales and marketing agent for SMS's laser light scatter products. As a result of this agreement, 24% of consolidated fiscal 1998 sales were through Veeco. In fiscal 1999, Schmitt and Veeco reached a mutual decision to terminate the partnership as sales by that entity had dropped dramatically (in fiscal 1999 sales to Veeco were less than 2% of consolidated revenues). The Company is dependent on the sales activities of its selling agents, and there can be no assurance these agents will continue to be successful in their efforts to market the Company's products. The Company enjoys substantial repeat business from a broad base of customers, but there can be no assurance that these customers will continue to buy the Company's products in the future. The decrease in revenues in fiscal 1999 occurred exclusively in the laser measurement products where the volume of product shipments declined as a result of the drop in business in the technology industry, primarily disk drive and silicon wafer manufacturers. Increased revenues during fiscal 1997 and 1998 principally resulted from increased volume of product shipments. Product improvements and available features have resulted in modestly increased average product prices.

The Company operates in highly competitive industries characterized by increasingly rapid technological changes. The Company's competitive advantage and future success are therefore dependent on its ability to develop new products, to qualify these new products with its customers, to successfully introduce these products to the marketplace on a timely basis, to commence production to meet customer demands and to develop new markets in the industries for its products and services. The successful introduction of new technology and products is increasingly complex. If the Company is unable, for whatever reason, to develop and introduce new products in a timely manner in response to changing market conditions or customer requirements, its results of operations could be adversely impacted.

[GRAPH]

RESULTS OF OPERATIONS

Sales in fiscal 1999 decreased to $7,957,723, from $10,626,084 in fiscal 1998 and $10,541,972 in fiscal 1997. Sales of Schmitt Balancing products in fiscal 1999 decreased to $7,377,879 from $7,532,112 in fiscal 1998, but increased from $6,151,473 in fiscal 1997. Schmitt Measurement System (SMS) sales accounted for $579,844 in fiscal 1999 compared to sales of $3,093,972 and $4,390,499 for fiscal 1998 and 1997 respectively. The net loss for fiscal 1999 totaled $259,307 compared to net income for fiscal 1998 of $1,250,115 and fiscal 1997 net income of $1,724,728. This decline was directly attributable to reduced sales of SMS measurement products.

Historically the Company has enjoyed a high gross profit margins in excess of 60% on its SBS Dynamic Balancing products and its SMS measurement products. Fiscal year 1999 gross profits totaled 48%. Cost of sales as a percentage of sales for fiscal 1997, 1998 and 1999 was 36.7%, 43.6% and 52.1%, respectively. Margins have declined for balancer products due to increased competitive pressures in all markets. With improvements to existing products and new technology, these results could improve in fiscal 2000 and beyond. Margins of measurement products declined due to the large reduction in sales of complete measurement systems. The fiscal 1999 and 1998 decline in sales of all laser measurement products resulted in a negative impact on sales and net earnings. Management expects the trends in sales and profits of both the balancer and measurement products to recover during fiscal 2000. Management anticipates that cost of sales as a percentage of sales will also recover in future time periods to achieve levels approximating the Company's historical performance. No assurances can be made that the Company will be profitable or will generate increased sales in future time periods.

General administrative and sales expenses as a percentage of net sales were 48% in fiscal 1999, 40% in fiscal 1998, and 40% in fiscal 1997. In terms of dollars, these expenses were $3,841,155, $4,275,059 and $4,164,271 in fiscal 1999, 1998 and 1997 respectively. The reduction in expenses in fiscal 1999 is due to a concerted effort by management to decrease expenses. In future fiscal periods, management believes the Company's costs will not increase at the same rate that sales are anticipated to increase, although there can be no such assurance.

Research and development expenses as a percentage of net sales were 5.8% in fiscal 1999, 3.6% in fiscal 1998 and 2.0% in fiscal 1997. In terms of dollars, these expenses were $462,136, $379,798 and $205,800 in fiscal 1999, 1998 and 1997 respectively. The Company has begun a major research and development program to develop products that will expand its market base and reduce reliance on historic market segments. This development program will continue in future fiscal periods, with expenditures expected to approximate those levels expended in fiscal 1999. The Company's future operating results depend, to a considerable extent, on its ability to maintain a competitive advantage in both the products and services it provides. For this reason, the Company believes it is critical to continue to make future investments in research and development to ensure the flow of innovative, productive, high-quality products and support services. Accordingly, the Company expects research and development expenses to continue to increase in the immediate future.

The company realized a net loss of $259,307 in fiscal 1999 compared to net income for fiscal 1998 of $1,250,115 and fiscal 1997 net income of $1,724,728. Net loss per basic share was $(0.03) compared to earnings per share of $0.18 in fiscal 1998 from $0.25 in fiscal 1997.

LIQUIDITY AND CAPITAL RESOURCES

The Company's financial condition remains very strong, with a ratio of current assets to current liabilities of 9.4 to 1 at May 31, 1999 compared to 7.3 to 1 at May 31, 1998. As of May 31, 1999, the Company had $268,888 in cash compared to $1,127,076 at May 31, 1998.

Accounts receivable balance at May 31, 1999 was $1,423,611 compared to $1,197,951 at May 31, 1998. This change from prior years is not significant as accounts receivable in fiscal 1999 turned 6.1 times per year compared to 5.4 times in fiscal 1998. At May 31, 1999, none of the Company's accounts receivable were considered a doubtful collection. The Company generally experiences a payment cycle of 30-80 days on invoices. Management believes its credit policies and collection policies are effective and appropriate for the marketplace that it serves and the Company has had no significant bad debt write-offs since its inception in 1986. There can be no assurance that the Company's collection procedures will continue to be successful.

TOTAL ASSETS
IN THOUSANDS OF DOLLARS
[GRAPH]

Working capital decreased slightly from $5,906,588 at May 31, 1998 to $5,812,075 at May 31, 1999. During fiscal 1999 and 1998, the Company spent $119,380 and $514,283 respectively to acquire certain worldwide corporate assets of property and equipment to assist in production and product development. Although the Company has no current material commitments for capital expenditures, product development to extend SBS and SMS products to new markets are expected to result in increased capital expenditures for equipment in fiscal 2000.

The Company maintains levels of inventory sufficient to satisfy normal customer demands, plus an increasing short-term delivery requirement for a majority of its products. Additionally, inventories are periodically adjusted according to management's forecast for future business activity. Management believes its ability to provide prompt deliveries gives it a competitive advantage for certain sales. It is expected that current inventory levels will be decreased as market conditions improve in the technology industry (disk drive and silicon wafer segments) and new products are introduced. Despite the introduction of new products, this new technology will utilize existing raw materials, thereby mitigating the level of additional inventory purchases in fiscal 2000. The average finished goods inventory turnover ratio for fiscal 1997, 1998 and 1999 was 1.8, 1.4 and 1.0 times, respectively.

During the third quarter of fiscal 1997, two officers/employees exercised stock options for 485,750 shares at an average exercise price of $1.79 per share. The officers/employees issued notes to the Company for the exercise price. The notes mature on or before December 2000 ($586,500) and January 2001 ($282,975), and carry interest at the rate of 6% per annum. The notes are reported as a reduction of stockholders' equity.

The company issued 610,000 shares of its common stock to acquire 13,757,155 shares or approximately 19.5% of the outstanding shares of Air Packaging Technologies, Inc. (APTI). That company is engaged in the design, manufacture, marketing and sales of "Air Box" patented packaging systems used in the semiconductor, electronic, medical and dental markets worldwide. The Company made this investment as the philosophy of APTI is similar to its own - to provide products that make its customers more profitable either through increased productivity or reduced operating costs.

The acquisition of SMS in fiscal 1995 resulted in a tax loss carryforward in of excess $5 million, which is available to offset earnings from SMS through the year 2009. As of May 31, 1999, approximately $3 million of these net-operating losses remain.

The Company has completed an assessment of the impact of the year 2000 issue on its internal systems and equipment, on its products and on the systems of its significant vendors. Costs to complete that assessment were less than one-half of one percent of fiscal 1999 revenues. Based on this assessment, the Company believes its internal systems have been updated to address the Year 2000 issue, its products will properly recognize calendar dates beginning in the Year 2000, and its significant vendors are appropriately addressing the Year 2000 issue. Accordingly, the Company believes it is Year 2000 ready and does not expect that the Year 2000 will have a material impact on the Company's business, results of operations or financial condition. However, there can be no assurance that the systems of other companies on which the Company relies will not have an adverse effect on the Company's systems.

Management believes its cash flows from operations, available credit resources and its cash position will provide adequate funds on both a short-term and long-term basis to cover currently foreseeable debt payments, lease commitments and payments under existing and anticipated supplier agreements. Management believes that such cash flow (without the raising of external funds) is sufficient to finance current operations, projected capital expenditures, anticipated long-term sales agreements and other expansion-related contingencies during fiscal 2000.

RETURN ON EQUITY
IN PERCENT

[GRAPH]

NET (LOSS) INCOME PER SHARE
IN DOLLARS

[GRAPH]

SUMMARIZED QUARTERLY FINANCIAL DATA

Fiscal year ended May 31, 1999 and 1998
In thousands, except per share information (unaudited)

Fiscal 1999 Quarter Ended	8/31/98	11/30/98	2/28/99	5/31/99
Sales	$1,984,671	$2,161,653	$1,767,427	$2,043,972
Gross Profit	961,503	985,628	997,700	867,612
Net (Loss) Income	(51,457)	(115,618)	16,844	(109,075)
Net (Loss) Income Per Share, Basic	$(0.01)	$(0.02)	$0.00	$(0.01)
Net (Loss) Income Per Share, Diluted	$(0.01)	$(0.02)	$0.00	$(0.01)
Market Price of Common Stock				
Low	$3.88	$3.13	$3.00	$1.94
High	$6.38	$5.00	$4.38	$4.00
Fiscal 1998 Quarter Ended	**8/31/97**	**11/30/97**	**2/28/98**	**5/31/98**
Sales	$2,666,941	$3,220,475	$2,372,320	$2,366,348
Gross Profit	1,504,589	1,833,637	1,059,200	1,596,173
Net Income	354,551	695,449	101,794	98,321
Net Income Per Share, Basic	$0.05	$0.10	$0.01	$0.01
Net Income Per Share, Diluted	$0.05	$0.09	$0.01	$0.01
Market Price of Common Stock				
Low	$7.50	$ 8.00	$7.38	$5.69
High	$9.75	$12.00	$10.13	$8.13

COMMON STOCK INFORMATION AND DIVIDEND POLICY

As of July 16, 1999, there were 8,184,889 shares of Common Stock outstanding held by approximately 130 holders of record. The number of holders does not include individual participants in security position listings. Management estimates that there are over 2,500 shareholders who own the Company's stock.

The Company has not paid any dividends on its Common Stock since 1994. The Company's present policy is to retain earnings to finance the Company's business. Any future dividends will be dependent upon the Company's financial condition, results of operations, current 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.

The sum of quarterly earnings per share does not equal annual earnings per share as a result of the computation of quarterly versus annual average shares outstanding.

WORKING CAPITAL
IN DOLLARS

[GRAPH]

SELECTED FINANCIAL DATA

In thousands, except per share information

FISCAL YEAR ENDED MAY 31, 1999 AND 1998

Fiscal Year Ended	5/31/99	5/31/98	5/31/97	5/31/96	5/31/95
Sales	$ 7,958	$10,626	$10,542	$7,080	$4,415
Net (Loss) Income	(259)	1,250	1,725	1,217	249
Net (Loss) Income Per Share, Basic	(0.03)	0.18	0.25	0.18	0.04
Weighted Average. Number Shares (000), Basic	7,592	7,091	7,031	6,888	6,887
Net (Loss) Income Per Share, Diluted	(0.03)	0.17	0.23	0.16	0.04
Weighted Average Number Shares (000), Diluted	7,592	7,456	7,562	7,417	7,116
Stockholders' Equity	$10,587	$ 8,688	$ 7,429	$4,887	3,464
Total Assets	$11,282	$ 9,619	$ 8,515	$5,986	$4,619

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders of
Schmitt Industries, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of cash flows and of changes in stockholders' equity present fairly, in all material respects, the financial position of Schmitt Industries, Inc. and its subsidiaries at May 31, 1999 and May 31, 1998, and the results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above. The financial statements of Schmitt Industries, Inc. as of May 31, 1997 and for the year then ended were audited by other independent accountants whose report dated July 10, 1997 expressed an unqualified opinion on those statements.

PricewaterhouseCoopers LLP
Portland, Oregon
July 13, 1999

SCHMITT WORLDWIDE CUSTOMERS

Adam Opel AG
Allied Signal Aerospace Company
Allison Engine Company
American Axel
American Koyo Bearing Mfg. Corp.
American NTN Bearing Company
Asahi Komag
Atlas Copco Airpower N.V.
Audi AG
Barden Corporation
Black & Decker Corporation
Blohm Maschinenbau Gmbh
BMW Motoren GmbH
Boeing Company
Briggs & Stratton
Bryant Grinder Corporation
Caterpillar Belgium S.A.
Caterpillar Incorporated
Chrysler Corporation
Cincinnati Milacron
Cummins Engine Company
Daewoo International Corporation
Daimler Benz
Dana Corporation
Deere & Company
Diesel Technology Corporation
Dresser-Rand
Eaton Corporation
Emerson Power Transmission
Erwin Junker

FAG Bearing Ltd.
Federal Mogul Corporation
Fiat
Ford France S.A.
Ford Motor Company
Fuji Electric
General Electric Corporation
General Motors Corporation
Goldcrown Machinery
Greenfield Industries
Guhring Automation
Harley-Davidson Motor Company
HMT Technology Corporation
Honda Motor Company, Honda
Of America
IBM Deutschland
INA Bearing Corporation
Jones &Shipman, Inc.
Komag, Inc.
Koube Steel
Koyo Machinery USA
Landis, Landis Lund
Lockheed Martin
Mercedes Benz AG
Milwaukee Electric Tool
Mitsubishi Chemical
Mitsubishi Material Silicon
Mitsubishi Motor Company Ltd.
NASA
Navistar International Transportation
New Venture Gear
Nissan Motors Ltd.
Normac, Inc.
Norton Company
Okamoto Corporation
Okunia Machinery, Inc.
Opel Austria GmbH

Parker Hannifin Corporation
Pratt & Whitney
Raytheon
Reliance Electric Company
Rexnord Corporation
Reynolds Metals
Robert Bosch Corporation
Robert Bosch GmbH
Saturn Corporation
Seagate Substrates
SEH America, Inc.
Siemens Automotive Systems
SKF Bearing Industries
SKF GmbH
Sumitomo Heavy Industries
Texas Instruments
The Timken Company
The Torrington Company
Timken France
Toyoda Machinery USA, Toyoda
Machinery, Ltd.
TRW Automotive Components
United Grinding Technologies
University Of Connecticut Grinding
Research Center
Volkswagen AG
Volvo
Weldon Machine Tool
Western Digital
Weyburn-Bartel

EXHIBIT 21.1

SUBSIDIARIES OF SCHMITT INDUSTRIES, INC.
AS OF MAY 31, 1999

Subsidiary	State of Incorporation or Country in Which Organized
Schmitt Measurement Systems, Inc.	Montana
Schmitt Hoffman Systems GmbH	Germany
Schmitt Europe, Ltd.	United Kingdom

Exhibit 23.1

[LETTERHEAD]

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No 333-3910) of Schmitt Industries, Inc. of our report dated July 13, 1999 relating to the financial statements, which appears in the Annual Report to Shareholders, which is incorporated in this Annual Report on Form 10-K.

PricewaterhouseCoopers LLP

Portland, Oregon
August 27, 1999

Exhibit 23.2

[LETTERHEAD]

CONSENT OF INDEPENDENT AUDITORS

We consent to the inclusion in this Annual Report on Form 10-K, and to the inclusion in the Form S-8 Registration Statement No. 333-3910, of our report dated July 10, 1997, on our audits of the consolidated financial statements of Schmitt Industries, Inc., and its subsidiaries.

/s/ Moss Adams LLP

Portland, Oregon
August 27, 1999

<ARTICLE> 5
<LEGEND>
THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM SCHMITT INDUSTRIES, INC. INDEPENDENT AUDITORS' REPORT AND CONSOLIDATED FINANCIAL STATEMENTS FOR THE FISCAL YEARS ENDED MAY 31, 1999, 1998, AND 1997 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.
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<ALLOWANCES>	0
<INVENTORY>	4,444,012
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<PP&E>	2,580,504
<DEPRECIATION>	926,314
<TOTAL-ASSETS>	11,282,414
<CURRENT-LIABILITIES>	695,854
<BONDS>	0
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<COMMON>	7,284,445
<OTHER-SE>	0
<TOTAL-LIABILITY-AND-EQUITY>	11,282,414
<SALES>	7,957,723
<TOTAL-REVENUES>	7,957,723
<CGS>	4,145,280
<TOTAL-COSTS>	4,303,291
<OTHER-EXPENSES>	118,310
<LOSS-PROVISION>	0
<INTEREST-EXPENSE>	(22,736)
<INCOME-PRETAX>	(395,274)
<INCOME-TAX>	(135,967)
<INCOME-CONTINUING>	0
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<CHANGES>	0
<NET-INCOME>	(295,307)
<EPS-BASIC>	(0.03)
<EPS-DILUTED>	(0.03)