UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal year ended: May 31, 2004

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

2765 N.W. Nicolai Street
Portland, Oregon 97210
(Address of principal executive offices) (Zip Code)

(503) 227-7908
(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
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 ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).
Yes ☐ No. ☒

As of June 30, 2004, the aggregate market value of the registrant's Common Stock held by nonaffiliates of the registrant was $9,576,164 based on the closing sales price of the registrant's Common Stock on the Nasdaq SmallCap Market. On that date, there were 2,474,461 shares of Common Stock outstanding.

Documents Incorporated by Reference

Portions of the registrant's definitive Proxy Statement for its 2004 Annual Meeting of Shareholders are incorporated by reference into Part III hereof.

PART I

Item 1. Business

Introduction

The Company (an Oregon corporation) designs, assembles and markets computer-controlled balancing equipment (the Balancer Segment) primarily to the machine tool industry. Through its wholly owned subsidiary, Schmitt Measurement Systems, Inc. ("SMS"), an Oregon corporation, the Company designs, manufactures and markets precision laser measurement systems (the Measurement Segment). The Company also sells and markets its products in Europe through its wholly owned subsidiaries, Schmitt Europe Ltd. ("SEL"), located in the United Kingdom and Schmitt Europa GmbH ("SEG"), located in Germany. The Company's executive offices are located at 2765 N.W. Nicolai Street, Portland, Oregon 97210, and its telephone number is (503) 227-7908.

Balancer Segment

The Company's principal product is the Schmitt Dynamic Balance System (the "SBS System"), consisting of a computer control unit, sensor, spindle-mounting adapter, and balance head. It is designed to be an inexpensive, yet highly accurate, permanent installation on grinding machines. The Company acquired its original balancing equipment technology pursuant to a series of agreements from 1987 through 1991 and substantially enhanced and advanced the patented technology since that time. Since inception the targeted customer base has been operators of grinding machines.

The SBS System is fully automated, eliminating the need to pre-balance such devices as grinding wheels. This reduces machine setup time 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 driven by electric motors through a precision gear train. These weights are repositioned to offset any imbalance in a grinding wheel or other application. Imbalance or vibration is picked up by the sensor that feeds a signal to a controller that filters the signal by revolutions per minute. The controller then drives the balance head weights in a direction that reduces the amplitude of the vibration signal. The balance cycle is complete when the weights are positioned to achieve the lowest vibration level.

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, virtual 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 static balancing, longer life of the grinding wheel, diamond dressings and spindle bearings, the ability to balance within 0.02 microns and its adaptability to all types of machines.

Precision grinding is necessary in all major manufacturing areas including 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. Precision grinding has an established worldwide presence in all industrialized countries and is expanding as a method of material removal and processing. Therefore, the Company believes there may be an increase in market growth and the need for automatic balancing. Within the industry there are three major market segments:

> ***Machine Tool Builders -*** These companies design and manufacture a variety of cylindrical, surface and specialty application grinding machines. SBS Systems 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 incorporating the SBS System into its machine.
>
> Examples of some well-known worldwide machine tool builders who have offered and/or installed the SBS System include ANCA (Australia), Blohm Incorporated (U.S.), Blohm GmbH (Germany),

Capco Machinery (U.S.), Cincinnati Milacron (U.S.), Ecotech/SMTW (China/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), Shigiya Machine (Japan), Sumitomo Heavy Industry (Japan), CETOS Hostivar (Czech Republic), TOS Holice (Czech Republic), Toyoda Machine (Japan) and Weldon Machine Tool (U.S.). The Company currently sells its products directly to most of the major machine builders in the U.S. and Western Europe.

Machine Tool Rebuilders – These customers, found in all industrial nations, develop their business by offering to completely update and refurbish older grinding machines. These rebuilders typically tear the old machine apart and install new components, such as the SBS System. The Company currently sells its products directly to major machine rebuilders in the U.S. and Western Europe.

Grinding Machine Users - These end users become aware of the SBS System through trade shows, trade magazine advertising, distributors, field representatives, referrals and new machine suppliers. The Company's business is conducted worldwide with some better known customers including: Black & Decker, Briggs and Stratton, 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 SEG added other technology and designs, including the internal spindle, ring and water balancer designs to the Company's product line (the SEG systems). These proven designs allow Schmitt to provide products to a broad range of machine applications.

In Fiscal 2004, 2003 and 2002, net sales of the Company's balancing products totaled $5,924,854, $5,481,010 and $5,275,556 respectively. Net sales of balancing products accounted for 75% of the Company's revenue in Fiscal 2004, 74% in Fiscal 2003 and 77% in Fiscal 2002. See Note 9 to Consolidated Financial Statements.

***Competition*:**

Management believes the SBS System is one of few fully automatic balancing systems marketed in the world. Most competitive products require special setup and training or calibration to the specific machine. The Company believes the SBS System is currently the only balancing product 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 come from European companies located in Switzerland, Germany, Spain and Italy. These competitors produce electromechanical balancers similar to the SBS System and water balancers similar to the SEG system. The Company considers these companies, with their established European base, to be the major competitors. These balancers have electronic deficiencies, rendering them less effective in solving essential balancing requirements. They cannot achieve the consistent low balance levels at 500-rpm (low speed) or at 7,500 rpm (high speed) as the SBS system can. In addition, these balancers have inferior brush and cable assemblies that cause down time and high maintenance. Finally, none of these companies can currently compete effectively with the Company in providing mounting adapters for all grinding machines.

Water balancers are the oldest on the market and are employed in the SEG-installed systems. They require expensive plumbing and water chambers to be machined into the wheel hub while the SBS System does not. They are currently priced about 1.25 times the level of the SBS System. To install these systems, the grinding machines must be disassembled and parts remachined or replaced within the spindle assembly. This can take two days, far longer than required to install the SBS system. The water system is "tuned" or "calibrated" to the machine by a factory service technician while the SBS system can be installed by the operator. Water systems work at mid- and high-speeds but cannot balance in low rpm environments while SBS products work in both environments. Water systems require periodic monitoring while the SBS systems require little or no operator monitoring.

The SBS System list price is generally $7,995 worldwide. Competitors' electromechanical systems are priced at $8,000 to $10,000 worldwide while water balancers are priced at $9,000 to $11,000 worldwide. Management believes 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 foremost product with the best quality, reliability and performance and superior economic value.

Measurement Segment

The Company manufactures and markets a line of laser-based, precision measurement systems and operates a precision laser light scatter measurement laboratory. 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 information can determine material characteristics such as surface roughness, defects and dimensional sizing without introducing contaminants and causing changes to the tested material. The principal products are laser-based measurement products and technology applicable to both industrial and military markets. The Company has used patents, patent applications, trademarks and other proprietary technology to focus marketing efforts on industrial markets, including electronics, computer disk and silicon wafer manufacturers.

There are four product lines: laser-based light-scatter measurement, dimensional sizing, research and other laser alignment products and a light-scatter measurement laboratory.

Laser-based light-scatter measurement:

These products use a patented laser light scatter technology to perform rapid, accurate, repeatable and non-destructive non-contact surface measurement tests that quantify surface micro-roughness. 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, with surface roughness outside that narrow band resulting in a reduction in data density or storage capacity. The Company's technology simultaneously measures disk surface roughness in two directions, radially, when the read/write head is moving to another disk sector and circumferentially, when the read/write head is processing information on the disk. The two separate roughness levels are required for proper head operation. The precise measurement methods provided by the Company's products are not possible through any other cost effective measurement means. The following two products meet the challenges of disk drive manufacturers and help prevent such problems from occurring:

- The original TMS-2000 (Texture Measurement System) product, the world's fastest and most accurate non-contact texture measurement system, revolutionized disk-manufacturing technology. The product (used on aluminum substrates) is currently used worldwide by most major disk drive manufacturers and provides fast, accurate and repeatable microroughness measurements and quadruples production throughput when compared to other testing devices. Surface roughness can now be measured to levels below 0.5 Angstroms (the point of a needle is one million Angstroms in diameter).

- The TMS-2000-DUV product measures the surface microroughness of glass rather than aluminum substrates. Manufacturers require the technology and products to measure surface roughness of these substrates to the same exact levels as those that measure aluminum. The Deep Ultra-violet light (DUV) technology and product uses the patented light scatter technology to measure the surface roughness of glass substrates to levels less than one Angstrom.

Customers include IBM, Seagate Substrates, Western Digital and Komag, Inc.

There are two products devoted to the silicon wafer industry, the TMS-2000W and TMS-3000W. Both of these products provide fast, accurate, repeatable measurements for manufacturers of silicon wafers, computer chips and memory devices. This industry demands manufacturing precision to increase performance and capacity and these products help achieve those goals. Silicon wafers are carefully cut and polished to provide the base upon which a computer or memory chip is produced. Therefore, chip manufacturing is extremely dependent on the beginning surface roughness of the wafer. Since all silicon wafers exhibit a microscopic level of surface roughness, stemming from chemical deposition, grinding, polishing, etching, or any number of other production techniques, some method of measuring these surface characteristics is required. The wafer measurement products provide a way for SMS customers in this industry to quantify and control their manufacturing process. The system provides measurements to a few hundredths of an Angstrom, a level unachievable by other testing devices.

Dimensional Sizing Products:

These are products used in a wide range of industrial applications. These include steel casting, paper production, medical imaging, crane control and micron-level part and surface inspection. Presently, there are four product lines: the AR4000 distance measurement sensor, the AR4000 Line Scanner and the AR600 and AR200 series of triangulating laser displacement sensors.

The AccuRange 4000 is an optical distance measurement sensor for most diffuse reflective surfaces, but is ideally suited to level and position measurement, machine vision, autonomous vehicle navigation and 3D imaging applications . It operates by emitting a collimated laser beam that is reflected from the target surface and collected by a sensor. The sensor is suitable for a wide variety of distance measurement applications that demand high accuracy and fast response times. Notable features include the operating range for most surfaces (zero to fifty feet), fast response time (50 kHz maximum sample rate), compact and lightweight power design and has a tightly collimated output beam for small spot size. There are three output beam configurations available: visible infrared, eye safe infrared and reflective tape targets.

The AR4000 Line Scanner is used with the AccuRange 4000 to scan and collect distance data over a full circle. The scanner consists of a balanced, rotating mirror and motor with position encoder and mounting hardware for use with the AccuRange 4000. The scanner deflects the beam 90 degrees, sweeping it through a full circle as it rotates. The product can scan at rates of up to 2600 lines per minute, sweeps the laser beam through a full 360 degrees and is both compact and lightweight.

The AR600 series is a family of triangulating laser displacement sensors with excellent accuracy and sensitivity. The sensor projects a beam of visible laser light that creates a spot on the target surface. Reflected light from the surface is viewed from an angle by a line scan camera and the target's distance is computed from the image pixel data. The line includes 11 models measuring displacements from 1/8" to 50" and accuracy's down to .00015" (4 microns). They can operate on all types of surfaces at speeds up to 1250 samples/second. The product is extremely sensitive and can detect glass and liquid surfaces and also detect multiple surfaces of transparent materials, allowing great flexibility in specialized applications.

The AR200 line is the most compact series of triangulating laser displacement sensors. Four models cover metric measurement ranges from six to fifty millimeters. All models boast a 1/500 accuracy rating for measurements within twelve microns. The AR200 sensor is the only sensor of its kind to feature pushbutton selection of output signals. All models are standard with Analog, Limit Switch and Serial outputs. The AR200 sensors, much like the longer-range AR600 sensors, project a beam of visible laser light that creates a spot on the target surface. Reflected light from the surface is viewed from an angle by a line scan camera and the target's distance is computed from the image pixel data. The AR200-6M, -12M, -25M and -50M have ranges in millimeters that match their model number. The AR200 displacement sensor can not be overloaded and measures accurately even when a mirror reflects the entire light beam back to the detector.

Research and Other Measurement Products:

CASI Scatterometers are sold to companies and institutions involved in research efforts. 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. These products are measurement instruments providing customers with precise roughness measurements of optical surfaces, diffuse materials, semiconductor wafers, magnetic storage media and precision-machined surfaces, as well as surfaces affecting the cosmetic appearance of consumer products. Customers include Pratt & Whitney, Boeing, The U.S. Navy and Rockwell Collins North America.

The µScan System is a portable device consisting of a hand-held control unit, an interchangeable measurement head and a separate charging unit. To perform a measurement, the operator places the measurement head on the objective area and presses a button. Each measurement takes less than five seconds with results displayed and stored in system memory. The µScan 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.

Testing Laboratory:

The Company provides a highly advanced measurement services laboratory, using CASI Scatterometers, to a wide variety of industrial and commercial businesses that require precise measurements only advanced laser light scatter technology can provide. 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 manufacturers of critical optical components in aerospace and defense systems, including such companies as Aerojet, AT&T Bell Labs, Eastman Kodak, General Electric, IBM, NASA and dozens of other industrial companies, universities and government agencies.

In Fiscal 2004, 2003 and 2002, net sales of Measurement products totaled $1,999,912, $1,938,511 and $1,599,103 respectively and accounted for 25%, 26% and 23% of the Company's total sales in Fiscal 2004, 2003 and 2002 respectively.

Business and Marketing Strategy

The Company designs, assembles and markets all of its products with operations divided into a number of different areas.

The Vice President of Operations directs production of Balancer segment products including production, assembly, purchasing, engineering and technical services. Product marketing for all Balancer segment products is managed by the President/CEO. Two Marketing Managers are responsible for domestic sales while a third is responsible for sales in Mainland China, Taiwan and Korea. The Company also has one person who performs field service/sales. The President/CEO is responsible for European sales and oversees the efforts of the European Marketing Manager who is headquartered in the United Kingdom. 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 Balancer segment products in a variety of ways. First, are the channels provided by independent manufacturer's representatives and distributors. There are currently approximately 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, worldwide trade shows have proven to be an excellent source of business. Company representatives, usually one or more of the Marketing Managers and/or the President/CEO, attend these events along with local Company representatives. These individuals operate a display booth featuring an SBS System demonstration stand and product and technical literature. Representatives from all facets of the Company's target markets attend these trade shows.

Third, original equipment manufacturers (OEMs) include the Balancer segment products on the machine tools they produce. Users thus purchase the Balancer segment products concurrently with the machine tools. Conversely, end users of grinding machines that have purchased the SBS system directly from the Company, and after enjoying the benefits of the products, often request that SBS products be included with the new equipment they order from OEMs. The SBS Systems are often installed by machine builders prior to displaying their own machine tools at various trade shows, becoming 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. European distribution to customers is handled by shipping the product directly from the Company's Portland headquarters to the European subsidiary in the United Kingdom, who in turn sells and distributes the products.

The Vice President of Operations directs production of all Measurement segment products including production, assembly, purchasing, engineering and technical services. Similar to the parent company, the

Measurement segment uses a variety of methods to market and sell its products. First, a Marketing Manager, under the direction of the President/CEO, directs the overall worldwide marketing efforts for surface measurement products. Second, both a marketing and a sales manager, again under the direction of the President/CEO, direct the overall worldwide marketing and sales efforts for dimensional sizing products. Third, the Company has a nonexclusive distribution agreement with a company in Japan for the promotion and sale of Measurement segment products in Japan, Korea, Malaysia, Singapore, the Philippines and Taiwan. Fourth, 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 demonstrations of Measurement segment products along with product and technical literature. Representatives from all facets of the market to which the Company directs its sales efforts attend these trade shows. Finally, one of the best marketing channels is the testing laboratory. Once customers see the capabilities of the technology, it can lead to orders for the Company's laser based light scatter measurement products.

All Measurement segment products are assembled in the Portland, Oregon facility and shipped worldwide directly to customers.

The Balancer and Measurement segment customer bases each consist of over 250 companies respectively.

Manufacturing

There are no unique sources of supply or raw materials in any product lines. Essential electronic components, available in large quantities from various suppliers, are assembled into the Balancing and Measurement electronic control units under the Company's quality and assembly standards. Company-owned software and firmware are coupled with the electronic components to provide the basis of the Company's various electronic control units. Management believes several supply sources exist for all electronic components and assembly work incorporated into its electronic control systems. The primary outside supplier of electronic assemblies is Silicon Forest Electronics of Vancouver, Washington, 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 thirty days to supplement or replace Silicon Forest Electronics.

Mechanical parts for the Company's products are produced by high quality CNC machine shops. 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. The Company is presently transitioning its certification to the new ISO-2000 requirements.

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 Balancer and Measurement products, processes and methods which the Company believes provide it with a competitive advantage. The Company has a policy of seeking patents where appropriate on inventions concerning new products and improvements developed as part of its ongoing research, development and manufacturing activities. While patents provide certain legal rights of enforceability, there can be no assurance the historic legal standards surrounding questions of validity and enforceability will continue to be applied or that current defenses 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 and whether patents will be issued 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 manufactures its Balancer segment products under copyright protection in the U.S. for electronic board designs. Encapsulation of the finished product further protects the Company’s technologies including software.

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

While the Company pursues patent, trademark, trade secret and copyright protection for products and various 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

In Fiscal 1997, the Company began an ongoing research and development program to expand the product lines and capabilities of both product segments. The goal of this program is to expand the product base in historic markets and to enter new market areas so as to reduce reliance on historic market segments. Since that Fiscal year, the Company has continued to develop the following new balancing and laser measurement products.

The SB-4500 controller is now a multi-function unit providing the versatility to control several activities including all balancer products. It 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 measured to 0.02 microns or 0.75 millionths of an inch, a ten-fold performance improvement over the prior control unit. It also allows customers to balance their grinding machines faster, reducing costly down time and increasing factory throughput. This generation of computer control allows the future addition of new products.

The Acoustical Emissions Monitoring System (AEMS) is controlled by the SB-4500 controller and monitors the customers’ dressing and grinding processes 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 grinding machine to stop before real damage occurs. The benefits of the AEMS product to the customer include time savings from quick and easy setups, improved dressing and grinding processes, and elimination of expensive part and machine damage.

The disk drive industry presented the Company with the challenge of developing the technology and products to measure the surface roughness of glass substrates. Existing laser-based light-scatter technology was modified to produce the required light scatter information to provide the necessary measurements. The engineering staff developed the DUV (Deep Ultra-violet light) technology to measure surface microroughness of glass substrates to the same precise levels as existing products and at levels required by the industry. This technology compliments existing products and provides the Company the ability to supply solutions for all media used by the disk drive industry.

During Fiscal 2004, 2003 and 2002, the Company’s research and development expense totaled $30,370, $192,686 and $217,444 respectively. The Fiscal 2004 levels were lower than in prior years as the Company devoted much of its internal labor efforts (most R&D costs are internal labor costs) to expanding production levels and the transition of engineering and production of dimensional sizing products from

Menlo Park, CA to Portland, OR. Management expects amounts expended for R&D in Fiscal 2005 to return to levels approximating those experienced in Fiscal 2003 and 2002.

Business Risks

This report includes "forward-looking statements" as that term is defined in Section 21E of the Securities Exchange Act of 1934. Forward-looking statements can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," "seeks," "approximately," "intends," "plans," "estimates," "anticipates," or "hopes," or the negative of those terms or other comparable terminology, or by discussions of strategy, plans or intentions. For example, this section contains numerous forward-looking statements. All forward-looking statements in this report are made based on management's current expectations and estimates, which involve risks and uncertainties, including those described in the following paragraphs. Among these factors are the following:

- Demand for company products may change.
- New products may not be developed to satisfy changes in consumer demands.
- Failure to protect intellectual property rights could adversely affect future performance and growth.
- Production time and the overall cost of products could increase if any of the primary suppliers are lost or if any primary supplier increased the prices of raw materials.
- Fluctuations in quarterly and annual operating results make it difficult to predict future performance.
- The Company may not be able to reduce operating costs quickly enough if sales decline.
- The Company maintains a significant investment in inventories in anticipation of future sales.
- The lack of a line of credit agreement could impact future liquidity.
- Future success depends in part on attracting and retaining key management and qualified technical and sales personnel.
- The Company faces risks from international sales and currency fluctuations.

Such risks and uncertainties could cause actual results to be materially different from those in the forward-looking statements. Readers are cautioned not to place undue reliance on the forward-looking statements in this report. We assume no obligation to update such information.

Demand for Company products may change:

For several months prior to March 2004, the Company experienced soft market demand for its Balancer products. While specific reasons are difficult to pinpoint, the low demand was attributed to worldwide economic conditions, specifically those in the grinding machine industry, the primary market for the Company's Balancer products. Based upon analysis by management and the sales staff, the decline in sales did not appear to arise from the customer base shifting to competitor products. From March 2004 forward, the Company has seen increasing activity in the industry and as a result growing demand and sales of its Balancer segment products. Despite this increase in activity, there can be no assurances as to the duration or strength of this increasing demand.

Historically, management has responded to soft market conditions in several ways. First, it appears there is a significant portion of the marketplace that is not using the automatic balancing products of the Company or any of its competitors. The Company will therefore continue to devote its future R&D efforts toward developing products that will both broaden the scope of products offered to the current customer base plus offer products for new markets thereby reducing the reliance on historic markets. Second, in order to increase worldwide operating efficiency, management consolidated all engineering design and manufacturing operations in its main location in Portland, Oregon, a step that reduced operating costs. Management continues to evaluate production methods for the most efficient and cost effective methods. Finally, management continuously evaluates all operating costs and seeks to reduce costs where necessary.

The Measurement segment has historically relied heavily upon sales to disk drive and silicon wafer manufacturers. Conditions in those markets adversely affected sales beginning in Fiscal 1999 and those poor conditions continued into Fiscal 2003. Disk drive demand is largely tied to and dependent upon demand for personal computers. In Fiscal 2001, personal computer manufacturers warned of lower sales expectations and many initiated actions to significantly reduce costs. These soft market conditions continued into Fiscal Years 2002 and 2003. In Fiscal 2004, improving conditions have occurred in the disk drive market, although the future impact on sales of these improving economic conditions is unknown at this time.

The semiconductor industry also faced a down cycle beginning in Fiscal 2002 as the industry experienced backlog cancellations, resulting in slower revenue growth. The result is similar to disk drive manufacturers in that capital spending declined significantly and consequently so did demand for and sales of the Company's wafer products in Fiscal 2002 through 2004. Forecasts for that industry are for improvements in market conditions although similar to the disk drive market, the future impact of these improving economic conditions is unknown at this time.

Management will continue to market these products to these historic markets as it appears no other technology has been introduced that would make the laser light-scatter products technologically obsolete. There is the belief that once market conditions improve in the disk drive and silicon wafer markets, demand for the Company's products and technology will increase although most likely not to historic levels. Also, management believes there are other uses for the Company's laser light scatter technology and continues to evaluate R&D efforts to develop new products and introduce them to the marketplace.

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

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

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

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

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

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

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

Quarterly and annual operating results are likely to fluctuate in the future due to a variety of factors, some of which are beyond management's control. As a result of quarterly operating fluctuations, it is important to realize quarter-to-quarter comparisons of operating results are not necessarily meaningful and should not be relied upon as indicators of future performance

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

Operating expenses are generally fixed in nature and largely based on anticipated sales. During the second quarter of Fiscal 2002, Management responded to declining sales by instituting an expense reduction program that significantly reduced the break-even sales point. However, should sales decline significantly and rapidly, there is no guarantee management could take actions that would further reduce operating expenses in either a timely manner or without seriously impacting the operations of the Company.

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

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

The lack of a line of credit agreement could impact future liquidity:

The Company had a short-term credit line that expired on April 30, 2003 and the commercial bank chose not to renew the arrangement. While management believes it could secure credit from another source, there is no guarantee this can be accomplished or, if it is accomplished, the terms may not be as favorable as those under the expired line of credit.

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

Future success depends on the efforts and continued services of key management, technical and sales personnel. Significant competition exists for such personnel and there is no assurance key technical and sales personnel can be retained nor assurances there will be the ability to attract, assimilate and retain other highly qualified technical and sales personnel as required. There is also no guarantee key employees will not leave and subsequently compete against the Company. The inability to retain key personnel could adversely impact the business, financial condition and results of operations.

The Company faces risks from international sales and currency fluctuations:

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

International Sales

The Company's sales in the last three Fiscal years by geographic areas are:

	North America	Europe	Asia	Others
Fiscal 2004	$ 4,520,940	$ 1,777,250	$ 1,365,840	$ 260,736
Fiscal 2003	$ 4,150,797	$ 2,348,102	$ 849,940	$ 70,682
Fiscal 2002	$ 4,337,917	$ 1,627,203	$ 887,093	$ 22,446

Backlog

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

Employees

As of July 9, 2004, the Company employed 37 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 Portland, Oregon in three company-owned buildings with total approximate square footage of 40,500 square feet. SEL occupies a 1,893-square foot facility in Coventry, England pursuant to a three-year lease beginning June 1, 2002 with a basic monthly rent of £1,875 (approximately $3,400 as of July 9, 2004). SEG occupies a 620 square foot facility in Pfungstadt, Germany pursuant to a five-year lease beginning December 1, 2001 with a basic monthly rent of 658 Euros (approximately $800 as of July 9, 2004).

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, 2004.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

The Company's Common Stock is traded on the Nasdaq SmallCap Market 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 The Nasdaq Smallcap Market for the periods indicated.

Year Ended May 31, 2004	High	Low
First Quarter	$ 1.80	$ 1.24
Second Quarter	$ 2.52	$ 1.60
Third Quarter	$ 2.60	$ 1.91
Fourth Quarter	$ 2.58	$ 1.75

Year Ended May 31, 2003	High	Low
First Quarter	$ 1.65	$ 1.05
Second Quarter	$ 1.95	$ 1.11
Third Quarter	$ 1.50	$ 1.07
Fourth Quarter	$ 1.60	$ 0.80

As of June 30, 2004, there were 2,474,461 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

In thousands, except per share information

Year Ended		5/31/04		5/31/03		5/3102		5/31/01		5/31/00
Sales	$	7,925	$	7,420	$	6,875	$	7,580	$	8,854
Net Income (Loss)	$	517	$	(1,487)	$	(1,599)	$	(2,367)	$	561
Net Income (Loss) Per Share, Basic	$	.21	$	(.60)	$	(.64)	$	(.90)	$	0.21
Weighted Average No. Shares, Basic		2,439		2,468		2,488		2,635		2,701
Net Income (Loss) Per Share, Diluted	$	.20	$	(.60)	$	(.64)	$	(.90)	$	0.21
Weighted Average No. Shares, Diluted		2,524		2,468		2,488		2,635		2,869
Stockholders' Equity	$	6,114	$	5,665	$	7,251	$	8,930	$	10,128
Total Assets	$	7,100	$	6,272	$	8,161	$	10,291	$	10,953
Long-term debt (including current portion)	$	67	$	24	$	280	$	353	$	—

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

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 competition and technological change in the Company's industries and other factors detailed in the Company's SEC filings. Accordingly, actual results may differ, possibly materially, from the predictions contained herein.

RESULTS OF OPERATIONS

Overview

Balancer segment sales focus throughout the world on end-users, rebuilders and original equipment manufacturers of grinding machines. Beginning in Fiscal 2001, the global economic slowdown impacted Balancer segment sales through soft market demand in North America and Europe and therefore lower sales of Balancer products. However, starting in March 2004 improving economic conditions in North America resulted in increasing sales in that geographic market. Sales people, representatives and distributors throughout these geographic areas spend a large amount of time with targeted customers. They are finding many of the customers in the automotive, bearing and aircraft industries refer to improving economic conditions and its impact on the machine tool industry in North America as the reason for their recent increase in ordering activity. However, while those customers are optimistic regarding short term demand for Balancer products, they continue to remain uncertain as to the strength and duration of the improving business conditions in North America for their products. Market demand in Asia for the Balancer segment products continue to be strong with the expanding market and customer base believed to be the reasons for the continued growth in sales. The European market remains soft with customers seeing a lack of demand for their products and therefore their demand for Balancer products has been soft, with recent sales decreasing accordingly. The timing of the recovery in those markets is uncertain at this time.

The Measurement segment product line consists of both laser light-scatter and dimensional sizing products. The business operations and prospects for these two product lines are summarized as follows:

- Laser light-scatter products for disk drive and silicon wafer manufacturers – Until the acquisition of the Acuity Research subsidiary in Fiscal 2001, the primary target markets for Measurement products were disk drive and silicon wafer manufacturers and companies and organizations involved in research efforts. Management and the sales staff monitor industry publications and public financial information in order to judge the potential demand for products by the targeted industries. Over the past several months, this information has indicated improving demand for and sales of the products of those two industries. Also, frequent discussions with customers have confirmed the information presented in the public information. Sales to customers in these industries can be very cyclical and therefore the impact of this recovery on sales to the Company's laser light-scatter products is unknown at this time, although sales personnel have seen increasing interest and inquiries regarding the Company's products.

- Laser light-scatter products for research organizations – Historically the Company has sold two to three of these systems in each fiscal year and expects to do the same in Fiscal 2005.

- Dimensional sizing products – Historically these have been marketed and sold into market segments different from the laser-light scatter products. Until the most recent fiscal year, most sales were realized through repeat business and inquiries received through the Company's web site. Because of the market potential of these products, Management hired a marketing manager who joined the Company in mid-Fiscal 2003 and a sales manager in the first quarter of the current fiscal year. These two people have built a North America sales representative network that is seeking business rather than responding to inquiries. To date, sales representative organizations have been retained that cover most of the fifty states. During the fourth quarter of Fiscal 2003, Management made the decision to consolidate the operations of Acuity Research (which had been located in Menlo Park, California) into the Measurement segment operations in Portland, Oregon. This action reduced the engineering and administrative staff at Acuity by four people and, beginning in November 2003, reduced monthly rental costs by $7,500. As a result of the physical relocation of the Acuity business in the first fiscal quarter of the current year, operations were suspended for a period of time and served to dampen the sales volume of Acuity products in that period. The relocation was completed as of August 31, 2003. Management believes these recent actions will result in increased sales.

Critical Accounting Policies

Revenue Recognition – The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility is probable. For sales to all customers, including manufacturer representatives, distributors or their third-party customers, these criteria are met at the time product is shipped. When other significant obligations remain after products are delivered, revenue is recognized only after such obligations are fulfilled.

Accounts Receivable – The Company maintains credit limits for all customers that are developed based upon several factors, included but not limited to payment history, published credit reports and use of credit references. On a monthly basis, Management performs various analyses to evaluate accounts receivable balances to ensure recorded amounts reflect estimated net realizable value. This review includes accounts receivable agings, other operating trends and relevant business conditions, including general economic factors, as they relate to each of the Company's domestic and international customers. If these analyses lead Management to the conclusion that potential significant accounts are uncollectible, a reserve will be provided. The Company has had no significant bad debt write-offs since its inception in 1986. As of May 31, 2004, Management established a reserve of $32,550 to cover potential doubtful accounts.

Inventories – These assets are stated at the lower of cost or market on an average cost basis. Each Fiscal quarter, Management utilizes various analyses based on sales forecasts, historical sales and inventory levels to ensure the current carrying value of inventory accurately reflects current and expected requirements within a reasonable timeframe. As a result of this analysis at May 31, 2004, Management believes the inventory levels are sufficient based upon the expected requirements in Fiscal 2004 and beyond. Based upon the same analysis in Fiscal 2003, Management determined $401,673 of inventories were in excess of expected requirements and therefore these amounts were written off.

Long-term Deferred Tax Asset– The Company applies the asset and liability method in recording income taxes, under which deferred income tax assets and liabilities are determined, based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using currently enacted tax rates and laws. Additionally, deferred tax assets are evaluated and a valuation allowance is established if it is more likely than not that all or a portion of the deferred tax asset will not be realized. During the year ended May 31, 2003, and based upon the losses in the prior two Fiscal years, Management believed it was prudent for the Company to increase the valuation reserve to fully offset the estimated value of the deferred tax assets. Management continues to review the level of the valuation allowance on a quarterly basis.

Intangible Assets – There is a periodic review of intangible and other long-lived assets for impairment. This review consists of the analysis of events or changes in circumstances that would indicate the carrying amount of the asset may not be recoverable. Recoverability is determined by comparing the forecasted future net cash flows from the operations to which the assets relate, based on management's best estimates using the appropriate assumptions and projections at the time, to the carrying amount of the assets. If the carrying value is determined to be in excess of future operating cash flows, the asset is considered impaired and a loss is recognized equal to the amount by which the carrying amount exceeds the estimated fair value of the assets. As of May 31, 2004, Management does not believe impairment, as defined above, exists.

Discussion of operating results:

	Year ended May 31, 2004					
	Consolidated		Balancer		Measurement	
	Dollars	%	Dollars	%	Dollars	%
Sales	$ 7,924,766	100.0%	$ 5,924,854	100.0%	$ 1,999,912	100.0%
Cost of sales:						
Operations, exclusive of inventory write-downs	3,405,761	43.0%	2,727,405	46.0%	678,356	33.9%
Inventory write-downs	—	—	—	—	—	—
Cost of sales	3,405,761	43.0%	2,727,405	46.0%	678,356	33.9%
Gross profit	4,519,005	57.0%	$ 3,197,449	54.0%	$ 1,321,556	66.1%
Operating expenses	4,081,739	51.5%				
Income from operations	$ 437,266	5.5%				

	Year Ended May 31, 2003					
	Consolidated		Balancer		Measurement	
	Dollars	%	Dollars	%	Dollars	%
Sales	$ 7,419,521	100.0%	$ 5,481,010	100.0%	$ 1,938,511	100.0%
Cost of sales:						
Operations, exclusive of inventory write-downs	3,188,566	43.0%	2,661,510	48.6%	527,056	27.2%
Inventory write-downs	401,673	5.4%	18,561	0.3%	383,112	19.8%
Cost of sales	3,590,239	48.4%	2,680,071	48.9%	910,168	47.0%
Gross profit	3,829,282	51.6%	$ 2,800,939	51.1%	$ 1,028,343	53.0%
Operating expenses	4,231,699	57.0%				
Loss from operations	$ (402,417)	(5.4)%				

	Year Ended May 31, 2002					
	Consolidated		Balancer		Measurement	
	Dollars	%	Dollars	%	Dollars	%
Sales	$ 6,874,659	100.0%	$ 5,275,556	100.0%	$ 1,599,103	100.0%
Cost of sales:						
Operations, exclusive of inventory write-downs	2,944,937	42.8%	2,446,049	46.4%	498,888	31.2%
Inventory write-downs	—	—	—	—	—	
Cost of sales	2,944,937	42.8%	2,446,049	46.4%	498,888	31.2%
Gross profit	3,929,722	57.2%	$ 2,829,507	53.6%	$ 1,100,215	68.8%
Operating expenses	3,973,798	57.8%				
Loss from operations	$ (44,076)	(0.6)%				

Worldwide sales of Balancer products in Fiscal 2004 increased from Fiscal 2003 as sales to the North American and Asian markets increased by 5% and 69% respectively while they decreased in the European markets by 15%. The increase in North America is attributed to improving economic conditions and therefore increased customer demand while the increase in Asia is attributed to continued strong economic conditions. The decrease in Europe is attributed to ongoing economic weakness in the targeted customer markets. Worldwide sales of Balancer products in Fiscal 2003 increased from Fiscal 2002 as sales to the Asian and European markets increased by 4% and 30% respectively, while they decreased in the North American market by 8%. The increase in Asia is attributed to strong economic conditions while the increase in Europe is attributed to more aggressive and focused sales efforts. The decrease in North America is attributed to ongoing economic weakness in the targeted customer markets. Measurement product sales in Fiscal 2004 were comparable to those experienced in Fiscal 2003. Sales of Measurement products in Fiscal 2003 increased from those in Fiscal 2002 as Fiscal 2003 included the sale of several large value laser light-scatter products while in Fiscal 2002 there were no significant sales of those higher value products.

Cost of sales, as a percentage of sales, for the Balancer segment (when excluding the inventory write-down in Fiscal 2003) decreased in Fiscal 2004 when compared to Fiscal 2003 due to the geographic sales mix. Sales to the North American markets were a higher percentage of total Balancer segment sales in Fiscal 2004 than they were in Fiscal 2003. Unit sales prices in North America are higher than they are in other geographic markets and therefore the costs on those sales are lower as a percentage of sales than in other geographic markets. When sales to the North American market are a higher proportion of total sales, as they were in Fiscal 2004 compared to Fiscal 2003, the effect is to lower cost of sales as a percentage of sales. Cost of sales for the Balancer segment (when excluding the inventory write-down in Fiscal 2003) increased in Fiscal 2003 when compared to Fiscal 2002, again due to the geographic sales mix. In Fiscal 2003, sales to the European markets were a higher percentage of total Balancer segment sales than they were in Fiscal 2002. Due to competitive pressures, unit sales prices in Europe are lower than they are in other geographic markets and therefore the costs on those sales are higher as a percentage of sales than in other geographic markets. When sales to the European market are a higher proportion of total sales, as they were in Fiscal 2003 compared to Fiscal 2002, the effect is to increase cost of sales as a percentage of sales.

Cost-of-sales in the Measurement segment (when excluding the inventory write-down in Fiscal 2003) increased in Fiscal 2004 when compared to Fiscal 2003 and is attributed to the product sales mix. Cost-of-sales in the Measurement segment (when excluding the inventory write-down in Fiscal 2003) decreased in Fiscal 2003 when compared to Fiscal 2002 due to changes in the product sales mix.

The decrease in operating expenses between Fiscal 2004 and 2003 occurred primarily due to a decrease in payroll costs at the Acuity Research subsidiary. The costs at Acuity decreased due to the reduction in engineering and administration staff that occurred due to the consolidation of Acuity operations in Portland during the quarter ended August 31, 2003. These changes returned the overall operating expenses to an amount approximating Fiscal 2002 levels.

Net sales outside North America accounted for approximately 43% of the Company’s revenues in Fiscal 2004, 44% in fiscal 2003 and 37% in Fiscal 2002. Some foreign customers purchase in their own country’s currencies, thereby imposing on the Company a currency risk. All North American sales (56% of total sales in Fiscal 2004) were in U.S. dollars and the remaining Fiscal 2004 sales were in currencies other than U.S. dollars. To date, currency fluctuations have had minimal impact on sales. 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 international sales will continue to grow in future periods.

The net income for Fiscal 2004 of $516,585 ($0.20 per fully diluted share) compares to net losses of $1,487,131 ($0.60 per share) and $1,598,619 ($0.64 per share) in Fiscal 2003 and 2002 respectively. The net loss in Fiscal 2003 included four significant items: a $612,200 non-operating charge for a write-down of the Company’s long-term investment in Air Packaging Technologies, Inc, $401,673 in write-downs of excess inventory quantities, an increase in the deferred tax asset valuation allowance of $636,006 and a $24,060 reserve for doubtful accounts. When these items are excluded, the net income would have been $186,808. The net loss in Fiscal 2002 was primarily attributable to a $1,516,000 non-operating charge for a write-down of the Company's long-term investment in Air Packaging Technologies, Inc. When that item is excluded, the net loss in Fiscal 2002 would have been $82,619.

A substantial portion of the Company's revenues are derived from sales to end users through selling agents. 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 is no assurance these customers will continue to buy the Company's products.

For Fiscal years 2004, 2003 or 2002, sales to a single customer did not exceed 10% of total revenues.

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, qualify these new products with its customers, successfully introduce these products to the marketplace on a timely basis, commence production to meet customer demands and 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.

LIQUIDITY AND CAPITAL RESOURCES

The Company's ratio of current assets to current liabilities decreased to 5.7 to 1 at May 31, 2004 compared to 7.7 to 1 at May 31, 2003. As of May 31, 2004 the Company had $604,194 in cash compared to $410,245 at May 31, 2003.

During the year ended May 31, 2004, cash provided from operating activities amounted to $408,160 with the changes described as follows:

- The net income for the year ended May 31, 2004 of $516,585 plus three non-cash items: depreciation and amortization of $188,314, the increase in the provision for doubtful accounts of $8,490 and the write-down of the long-term investment of $6,800.

- Accounts receivable used cash as the balance increased by $499,707 (exclusive of the change in the allowance for doubtful accounts) to a May 31, 2004 balance of $1,815,417 compared to $1,324,200 at May 31, 2003. At May 31, 2004, $32,550 in accounts receivable were considered as doubtful of collection and therefore a reserve in that amount has been provided for. The Company generally experiences a payment cycle of 30-90 days on invoices, depending on the geographic market. Management believes its credit and collection policies are effective and appropriate for the marketplace. There can be no assurance that the Company's collection procedures will continue to be successful, particularly with current economic conditions.

- Inventories increased $189,162 to a May 31, 2004 balance of $2,915,093 compared to $2,725,931 at May 31, 2003. The Company maintains levels of inventory sufficient to satisfy normal customer demands plus an increasing short-term delivery requirement for a majority of its Balancer products. Management believes its ability to provide prompt delivery gives it a competitive advantage for certain sales.

- Prepaid expenses decreased by $42,844 due to the amortization of several items including prepaid trade show costs, professional fees and various business and life insurance costs.

- Trade accounts payable increased by $210,217 with the increase due to increased purchasing activities in both the Balancer and Measurement segments.

- Other accrued liabilities (including commission, payroll items and other accrued expenses) increased by $127,014.

During the year ended May 31, 2004, net cash used in investing activities was $110,482 consisting of net additions to property and equipment. Net cash used in financing activities amounted to $7,843, which consists of repayments on capitalized obligations of $35,678, common stock issued to employees exercising stock options for $67,835 and repurchases of common stock for $40,000.

The following summarizes contractual obligations at May 31, 2004 and the effect on future liquidity and cash flows:

Years Ending May 31,	Capital Lease and Purchase Contract	Operating Leases	Total Contractual Obligations
2005	$ 39,831	$ 50,841	$ 90,672
2006	22,247	9,625	31,872
2007	4,995	4,812	9,807
2008	—	—	—
2009	—	—	—
Thereafter	—	—	—
Total	$ 67,073	$ 65,278	$ 132,351

Part of the acquisition of SMS in Fiscal 1995 resulted in the acquisition of a tax net operating loss of approximately $5.5 million, which is available to offset domestic earnings through the year 2009. As of May 31, 2004, approximately $1.3 million of these losses remain.

The Company's $500,000 short-term line of credit agreement with a commercial bank expired on April 30, 2003. While Management believes it could secure credit from another source, there is no guarantee this could be accomplished or, if it is accomplished, the terms will be as favorable as those under the expired line of credit.

Management has responded to business challenges over the past few years by reducing operating expenses, developing new products and attempting to penetrate new markets for the Company's products. As a result of these efforts, Management believes its cash flows from operations 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 2005. However, in the event the Company fails to achieve its operating and financial goals for Fiscal 2005, Management may be required to take certain actions to finance operations in that time period. These actions could include, but are not limited to, implementation of additional cost cutting measures, increased borrowings from credit facilities or entering into additional borrowing arrangements collateralized by assets.

Item 7A. Qualitative and Quantitative Disclosures about Market Risk

Interest Rate Risk

The Company did not have any derivative financial instruments as of May 31, 2004. 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. Therefore, 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 does not have any lines of credit or other debt whose interest rates are based on variable rates that may fluctuate over time based on economic changes in the environment. Therefore, at this time, the Company is not subject to interest rate risk if market interest rates fluctuate and does not expect any change in the interest rates to have a material effect on the Company's results from operations.

Foreign Currency Risk

The Company operates subsidiaries in the United Kingdom and Germany. Therefore, the Company's business and financial condition is sensitive to currency exchange rates or any other restrictions imposed on their currencies. For the years ended May 31, 2004, 2003 and 2002, results of operations included gains (losses) on foreign currency translation of $40,608, $192,010 and $(15,470) respectively.

Item 8. Financial Statements and Supplementary Data

SCHMITT INDUSTRIES, INC.
CONSOLIDATED BALANCE SHEETS
MAY 31, 2004 AND 2003

	2004	2003
ASSETS		
Current Assets		
Cash	$ 604,194	$ 410,245
Accounts receivable, net of allowance for doubtful accounts of $32,550 and $24,060 in 2004 and 2003 respectively	1,815,417	1,324,200
Inventories	2,915,093	2,725,931
Prepaid expenses	124,348	167,192
Income taxes receivable	35,894	32,659
	5,494,946	4,660,227
Property and Equipment		
Land	299,000	299,000
Buildings and improvements	1,214,500	1,208,417
Furniture, fixtures and equipment	1,115,788	991,828
Vehicles	94,261	93,887
	2,723,549	2,593,132
Less accumulated depreciation and amortization	1,395,634	1,307,100
	1,327,915	1,286,032
Other Assets		
Long-term investment	—	6,800
Long-term deferred tax asset	—	—
Other assets	277,612	318,880
	277,612	325,680
TOTAL ASSETS	$ 7,100,473	$ 6,271,939
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$ 565,546	$ 355,329
Accrued commissions	189,679	148,953
Customer deposits	53,203	10,892
Other accrued liabilities	111,165	67,188
Current portion of long-term obligations	39,831	20,031
	959,424	602,393
Long-term Obligations	27,242	4,273
Commitments and Contingencies		
Stockholders' Equity		
Common stock, no par value, 20,000,000 shares authorized, 2,474,461 and 2,457,932 shares issued and outstanding at May 31, 2004 and 2003, respectively	7,360,819	7,332,984
Accumulated other comprehensive loss	(376,249)	(280,363)
Accumulated deficit	(870,763)	(1,387,348)
	6,113,807	5,665,273
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 7,100,473	$ 6,271,939

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

Schmitt Industries, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED MAY 31, 2004, 2003 AND 2002

	2004	2003	2002
Net Sales	$ 7,924,766	$ 7,419,521	$ 6,874,659
Cost of Sales			
Operations, exclusive of inventory write-downs	3,405,761	3,188,566	2,944,937
Inventory write-downs	—	401,673	—
Total cost of sales	3,405,761	3,590,239	2,944,937
Gross profit	4,519,005	3,829,282	3,929,722
Operating expenses:			
General, administrative and selling	4,051,369	4,039,013	3,756,354
Research and development	30,370	192,686	217,444
Total operating expenses	4,081,739	4,231,699	3,973,798
Operating income (loss)	437,266	(402,417)	(44,076)
Other income and (expense):			
Interest expense	(4,330)	(22,824)	(53,468)
Interest income	882	558	4,665
Loss on write-down of long-term investment	(6,800)	(612,200)	(1,516,000)
Gain (loss) on foreign currency exchange	40,608	192,010	(15,470)
Rental income	18,921	22,800	22,800
Miscellaneous (expense) income	30,038	(29,052)	2,930
Other income and (expense)	79,319	(448,708)	(1,554,543)
Income (loss) before provision for income taxes	516,585	(851,125)	(1,598,619)
Provision for income taxes	—	636,006	—
Net income (loss)	$ 516,585	$ (1,487,131)	$ (1,598,619)
Net income (loss) per common share, basic	$ 0.21	$ (0.60)	$ (0.64)
Weighted average number of common shares, basic	2,438,895	2,467,651	2,488,458
Net income (loss) per common share, diluted	$ 0.20	$ (0.60)	$ (0.64)
Weighted average number of common shares, diluted	2,524,050	2,467,651	2,488,458

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

Schmitt Industries, Inc.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED MAY 31, 2004, 2003 AND 2002

	Shares	Amount	Accumulated Other Comprehensive (Loss)	Retained Earnings (Accumulated Deficit)	Total	Total Comprehensive Income (Loss)
Balance, May 31, 2001	2,501,931	$ 7,407,476	$ (175,954)	$ 1,698,402	$ 8,929,924	
Common shares repurchased	(33,499)	(63,855)	—	—	(63,855)	
Net (loss)	—	—	—	(1,598,619)	(1,598,619)	$ (1,598,619)
Other comprehensive (loss)	—	—	(16,793)	—	(16,793)	(16,793)
Balance, May 31, 2002	2,468,432	7,343,621	(192,747)	99,783	7,250,657	
Comprehensive (loss), year ended May 31, 2002						(1,615,412)
Common shares repurchased	(10,500)	(10,637)	—	—	(10,637)	
Net (loss)	—	—	—	(1,487,131)	(1,487,131)	$ (1,487,131)
Other comprehensive (loss)	—	—	(87,616)	—	(87,616)	(87,616)
Balance, May 31, 2003	2,457,932	$ 7,332,984	$ (280,363)	$ (1,387,348)	$ 5,665,273	
Comprehensive (loss), year ended May 31, 2003						$ (1,574,747)
Common shares repurchased	(40,000)	(40,000)	—	—	(40,000)	
Stock options exercised	56,529	67,835			67,835	
Net income	—	—	—	516,585	516,585	$ 516,585
Other comprehensive (loss)	—	—	(95,886)	—	(95,886)	(95,886)
Balance, May 31, 2004	2,474,461	$ 7,360,819	$ (376,249)	$ (870,763)	$ 6,113,807	
Comprehensive income, year ended May 31, 2004						$ 420,699

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

Schmitt Industries, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED MAY 31, 2004, 2003 AND 2002

	2004	2003	2002
Cash Flows Relating to Operating Activities			
Net loss	$ 516,585	$ (1,487,131)	$ (1,598,619)
Adjustments to reconcile net income (loss) to net cash provided by operating activities			
Write-down of long-term investment	6,800	612,200	1,516,000
Write-down of excess inventory quantities	—	401,673	—
Depreciation and amortization	188,314	240,265	245,138
Deferred taxes	—	636,006	122,865
Provision for bad debts	8,490	24,060	—
(Increase) decrease in:			
Accounts receivable	(499,707)	(213,224)	92,121
Inventories	(189,162)	80,518	350,916
Prepaid expenses	42,844	(5,312)	24,690
Income taxes receivable	(3,235)	123,977	(122,975)
Increase (decrease) in:			
Accounts payable	210,217	116,321	(179,079)
Accrued commissions and other accrued liabilities	127,014	35,730	(198,594)
Net cash provided by operating activities	408,160	565,083	252,463
Cash Flows Relating to Investing Activities			
Purchase of property and equipment	(108,796)	(74,505)	(110,458)
Disposal of property and equipment	(1,686)	26,399	39,377
Net cash used in investing activities	(110,482)	(48,106)	(71,081)
Cash Flows Relating to Financing Activities			
Line of credit repayments	—	(200,000)	(400,000)
Line of credit borrowings	—	—	400,000
Proceeds of long-term borrowings	—	38,250	33,877
Repayment of long-term debt	(35,678)	(294,408)	(106,015)
Common stock issued	67,835	—	—
Common stock repurchased	(40,000)	(10,637)	(63,855)
Net cash (used in) financing activities	(7,843)	(466,795)	(135,993)
Effect of foreign exchange translation on cash	(95,886)	(87,616)	111,207
Increase (decrease) in cash	193,949	(37,434)	156,596
Cash, beginning of year	410,245	447,679	291,083
Cash, end of year	$ 604,194	$ 410,245	$ 447,679
Supplemental Disclosure of Cash Flow Information			
Cash paid during the period for interest	$ 4,330	$ 22,824	$ 58,771
Cash paid during the period for income taxes	$ 4,035	$ 26,110	$ 110
Supplemental Schedule of Noncash Investing and Financing Activities			
Fixed assets financed	$ 78,447	$ —	$ —
Increase (decrease) in market value of long-term investment	$ —	$ —	$ (273,000)
Increase in long-term deferred tax asset	$ —	$ —	$ 145,000

The accompanying notes are an integral part of these consolidated statements

Schmitt Industries, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED MAY 31, 2004, 2003 AND 2002

NOTE 1
ORGANIZATION AND NATURE OF OPERATIONS

Schmitt Industries, Inc. (the Company) designs, assembles, markets and distributes electronic and mechanical components for machine tool products and laser measurement systems worldwide.

NOTE 2
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

These consolidated financial statements include those of the Company and its wholly owned subsidiaries: Schmitt Measurement Systems, Inc. (SMS), Schmitt Europe, Ltd. (SEL) and Schmitt Europa GmbH (SEG). All significant intercompany accounts and transactions have been eliminated in the preparation of the consolidated financial statements.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility is probable. For sales to all customers, including manufacturer representatives, distributors or their third-party customers, these criteria are met at the time product is shipped. When other significant obligations remain after products are delivered, revenue is recognized only after such obligations are fulfilled.

Cash and Cash Equivalents

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.

Accounts Receivable

The Company maintains credit limits for all customers that are developed based upon several factors, included but not limited to payment history, published credit reports and use of credit references. On a monthly basis, Management performs various analyses to evaluate accounts receivable balances to ensure recorded amounts reflect estimated net realizable value. This review includes accounts receivable agings, other operating trends and relevant business conditions, including general economic factors, as they relate to each of the Company’s domestic and international customers. If these analyses lead Management to the conclusion that potential significant accounts are uncollectible, a reserve will be provided. The Company has had no significant bad debt write-offs since its inception in 1986.

Inventory

Inventory is valued at the lower of cost or market with cost determined on the average cost basis. As of May 31, 2004 and 2003, inventories consisted of raw materials ($1,824,897 and $1,346,513, respectively), work-in-process ($68,287 and $1,527, respectively), and finished goods ($1,021,909 and $1,377,891, 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.

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 included as a separate component of stockholders' equity titled "Accumulated Other Comprehensive Loss."

Advertising

Advertising costs included in marketing, general and administrative, are expensed when the advertising first takes place. Advertising expense was $86,648, $67,530 and $79,306 for the fiscal years ended May 31, 2004, 2003 and 2002, respectively.

Research and Development Costs

Research and development costs are charged to expense when incurred.

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 in 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.

The Company has adopted the disclosure only provisions of SFAS 123. Accordingly, no compensation cost has been recognized for the stock option plans. Adjustments are made for options forfeited prior to vesting. No stock options were granted during the year ended May 31, 2004. For the years ended May 31, 2003 and 2002, total value of options granted was computed to be $7,158 and $110,532, respectively, which would be amortized on the 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 2003 and 2002, consistent with the provisions of SFAS 123, the Company's pro forma net income (loss) for the years ended May 31, 2004, 2003 and 2002, would be $487,648, $(1,591,321) and $(1,709,151), respectively. Pro forma basic and fully-diluted earnings (loss) per share for the years ended May 31, 2004, 2003 and 2002 would be $.20 $(.64) and $(.69) respectively.

Pursuant to SFAS 123, the fair value of each option granted is estimated on the date of the grant using the Black-Scholes option pricing model. The weighted average assumptions used for Fiscal 2004, 2003 and 2002 were a risk-free interest rate of 3.50% for 2004 and 2003 and 4.00% for 2002, an expected dividend yield of 0% for all years, an expected life of four years for Fiscal 2004, 2003 and 2002 and a volatility of 91%, 119% and 121%, respectively.

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

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 as measured by the enacted tax rates which are expected to be in effect when these differences reverse. Income tax expense is the tax payable for the period and the change during the period in net deferred tax assets and liabilities. Management establishes a valuation allowance against its net deferred tax assets to reduce the net asset to the amount that, based upon their evaluation, will more likely than not be realized.

Earnings Per Share

Basic earnings per share is computed using the weighted average number of shares outstanding. Diluted earnings per share is computed using the weighted average number of shares outstanding, adjusted for dilutive incremental shares attributed to outstanding options to purchase common stock.

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.

Financial Instruments

The carrying amounts of financial instruments approximate their fair values at May 31, 2004.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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.

New Accounting Pronouncements

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", which establishes standards for how certain financial instruments are classified when it has characteristics of both liabilities and equity. SFAS No. 150 requires instruments which were previously classified as equity, that meet the scope of the pronouncement, be classified as liabilities. The Company began applying the provisions of this statement in November 2003. The initial adoption of this standard did not have any effect on the Company's financial position, results of operations or cash flows.

Reclassifications

Certain reclassifications have been made to 2003 and 2002 amounts to conform to the 2004 presentation.

NOTE 3

ACCOUNTS RECEIVABLE

Changes in the Company's allowance for doubtful accounts is as follows:

	2004	2003
Beginning balance	$ 24,060	$ —
Bad debt expense	17,742	24,060
Accounts written off	(9,252)	—
Ending balance	$ 32,550	$ 24,060

NOTE 4
LONG-TERM INVESTMENTS
The Company owns 1,375,716 shares or approximately 9% 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 retail, industrial protective and promotional packaging markets worldwide. This investment is classified as "Available-for-sale securities" under Statement of Financial

Accounting Standards No. 115 (SFAS No. 115). As required under that statement, all unrealized gains and losses are reported in Accumulated Other Comprehensive Loss and included as a separate component in Other Comprehensive Loss in Stockholders' Equity until realized or until unrealized losses are deemed to be "other than temporary".

At May 31, 2004 Management determined the decline in value of the investment from acquisition cost was "other than temporary", and, as required under SFAS No. 115, the long-term investment was written down by $6,800 to its fair market value as of May 31, 2004. Fair market value was the closing price of the stock on the over-the-counter market at May 31, 2004. As required under SFAS No. 115, the new cost basis shall not be changed for subsequent recoveries in fair value. Future temporary gains and losses will be reported as required under SFAS No. 115.

NOTE 5
INCOME TAXES

The provision (benefit) for income taxes was as follows

	Years ended May 31,		
	2004	2003	2002
Current	$ —	$ —	$ —
Deferred	226,827	(363,021)	(533,183)
(Decrease) increase in valuation allowance	(226,827)	999,027	533,183
Total provision for income taxes	$ —	$ 636,006	$ —

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

	2004	2003
Depreciation	$ —	$ 19,679
Net operating loss carryforwards	1,244,724	704,324
Deferred taxes related to the write-off of obsolete inventory quantities	—	744,139
Deferred taxes related to the decline in fair market value of long-term investment	819,840	817,229
Other deferred assets	83,481	89,501
Gross deferred tax assets	2,148,045	2,374,872
Deferred tax asset valuation allowance	(2,148,045)	(2,374,872)
Net deferred tax asset	$ —	$ —

The Company has approximately $1.9 million of U.S. federal net operating loss carryforwards that were acquired as part of the acquisition of Schmitt Measurement Systems, Inc. These NOLs are subject to limitations that restrict their use and expire in the years 2009 through 2010. The Company also has approximately $1.3 million of U.S. Federal and State net operating loss carryforwards, the utilization of which could be limited upon a change in control of the Company, and expire in the year 2024.

Due to the uncertainty of utilization of certain of the Company's NOLs and in consideration of other factors, management has recorded a valuation allowance on the deferred tax asset in 2003 and 2002 to reduce the net deferred tax asset to the amount that it has deemed will more likely than not be realized.

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 (loss) income due to the following:

	Years Ended May 31,		
	2004	2003	2002
Statutory federal tax rate	34.0%	(34.0)%	(34.0)%
State taxes, net of federal benefit	—	—	—
Change in deferred tax valuation allowance	(43.9)	117.4	29.8
Permanent and other differences	9.9	(8.7)	4.2
Effective tax rate	—%	74.7%	—%

NOTE 6
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 which may be partially matched by the Company. The Company may further make either a profit sharing contribution or a discretionary contribution. There were no contributions made by the Company to this Plan during the years ended May 31, 2004 and 2003, while during the year ended May 31, 2002 contributions were $47,881.

NOTE 7
LONG-TERM OBLIGATIONS

During Fiscal 2004, the Company entered into an equipment lease and a purchase contract for $78,477. The agreements call for monthly principal payments of $832 and $2,131 and both carry no interest. One lease expires in Fiscal 2006 and the second in Fiscal 2007. Equipment recorded under the equipment lease was $48,477, with related accumulated depreciation of $4,386.

As of May 31, 2004, future capital lease payments are:

Year Ending May 31,		
2005	$	39,831
2006	$	22,247
2007	$	4,995

NOTE 8
COMMITMENTS AND CONTINGENCIES

In a transaction related to the acquisition of Schmitt Measurement Systems, Inc., formerly TMA Technologies, Inc. (TMA), the Company established a royalty pool and vested in each shareholder and debt holder of the acquired company 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 from any claims with regard to the acquisition except their rights to future royalties. Royalty expense applicable to the years ended May 31, 2004, 2003 and 2002 amounted to $41,430, $48,517 and $27,763, respectively.

The Company has entered into various non-cancelable leases for facilities used to support operations in the United Kingdom, Germany and California. Rent expense for the years ended May 31, 2004, 2003 and 2002 amounted to $78,062, $136,953 and $136,374 respectively.

Lease commitments

Year Ending May 31,		
2005	$	50,841
2006	$	9,625
2007	$	4,812
2008	$	—
2009	$	—
Thereafter	$	—

Specific business challenges faced by the Company over the past few years have had a negative impact on operations and liquidity. Management has responded to these challenges by reducing operating expenses, developing new products and penetrating new markets for the Company's products. As a result of these efforts, Management believes its cash flows from operations 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 2005. However, in the event the Company fails to achieve its operating and financials goals in for Fiscal 2005, management may be required to take certain actions to finance operations in that time period. These actions could include, but are not limited to, implementation of additional cost cutting measures or entering into additional borrowing arrangements that are collateralized by assets.

NOTE 9
SEGMENTS OF BUSINESS

The Company operates principally in two segments of business: the design and assembly of dynamic balancing systems and components (Balancer) for the machine tool industry, and the design and assembly of laser measurement systems (Measurement). The Company also operates in two principal geographic markets, United States and Europe.

Segment Information

	Year Ended May 31,					
	2004		2003		2002	
	Balancer	Measurement	Balancer	Measurement	Balancer	Measurement
Gross sales	$ 6,644,781	$ 2,017,494	$ 6,283,987	$ 1,961,086	$ 6,197,649	$ 1,605,288
Intercompany sales	$ 719,927	$ 17,582	$ 802,977	$ 22,575	$ 922,093	$ 6,185
Net sales	$ 5,924,854	$ 1,999,912	$ 5,481,010	$ 1,938,511	$ 5,275,556	$ 1,599,103
Income (loss) from operations	$ 2,674	$ 434,592	$ (281,900)	$ (120,517)	$ (270,416)	$ 226,340
Intercompany rent	$ —	$ 30,000	$ —	$ 30,000	$ —	$ 30,000
Depreciation expense	$ 111,282	$ 35,764	$ 119,331	$ 60,486	$ 136,864	$ 53,671
Amortization expense	$ 6,665	$ 34,603	$ 20,002	$ 40,446	$ 20,000	$ 34,603
Capital expenditures	$ 90,848	$ 17,948	$ 38,970	$ 35,535	$ 80,491	$ 29,967

Geographic Information

Geographic Sales

	Year Ended May 31, 2004	2003	2002
North American Sales			
United States	$ 4,320,421	$ 3,985,882	$ 4,230,818
Intercompany	$ —	$ 22,134	$ 72,319
	$ 4,320,421	$ 3,963,748	$ 4,158,499
Canada	$ 154,738	$ 153,022	$ 151,732
Mexico	$ 45,781	$ 34,027	$ 27,686
North America total	$ 4,520,940	$ 4,150,797	$ 4,337,917
European Sales			
Germany	$ 469,342	$ 781,375	$ 897,670
Intercompany	$ —	$ —	$ 206,824
Germany total	$ 469,342	$ 781,375	$ 690,846
United Kingdom	$ 1,136,035	$ 1,253,639	$ 1,065,416
Intercompany	$ 737,509	$ 803,418	$ 649,135
United Kingdom total	$ 398,526	$ 450,221	$ 416,281
Other European Sales	$ 909,382	$ 1,116,506	$ 520,076
Total Europe	$ 1,777,250	$ 2,348,102	$ 1,627,203
Asia	$ 1,365,840	$ 849,940	$ 887,093
Others	$ 260,736	$ 70,682	$ 22,446
	$ 7,924,766	$ 7,419,521	$ 6,874,659

	Year Ended May 31, 2004		2003		2002	
	United States	Europe	United States	Europe	United States	Europe
Income (loss) from operations	$ 623,887	$ (186,621)	$ (292,905)	$ (109,512)	$ 113,812	$ (157,888)
Depreciation expense	$ 137,606	$ 9,440	$ 164,877	$ 14,940	$ 177,851	$ 12,684
Amortization expense	$ 41,268	$ —	$ 60,448	$ —	$ 54,603	$ —
Capital expenditures	$ 103,647	$ 5,149	$ 68,363	$ 6,142	$ 107,388	$ 3,070

Long-term Assets

	May 31, 2004	May 31, 2003
Segment:		
Balancer	$ 1,041,032	$ 994,798
Measurement	$ 564,495	$ 616,914
Geographic:		
United States	$ 1,585,021	$ 1,588,599
Europe	$ 20,506	$ 23,113

Note – Europe is defined as the two European subsidiaries, Schmitt Europe, Ltd. and Schmitt Europa, GmbH

NOTE 10
STOCK OPTIONS

The Board of Directors adopted a 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 might be either an incentive stock option (ISO), or a nonstatutory stock option (NSO). ISOs may be granted only to employees and members of the Board of Directors 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 at the discretion of the option committee of the Board of Directors, but is either 50% at grant date and 16.7% on each anniversary thereafter or 50% at grant date and 25% on each anniversary thereafter. The Company initially reserved 400,000 shares for issuance under the stock option plan. All outstanding options will expire no later than 2014.

The following summarizes the options outstanding as of May 31, 2004:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Options outstanding, May 31, 2001	225,666	$ 4.32	
Options granted	287,334	$ 1.44	
Options forfeited/cancelled	(269,000)	$ 4.08	
Options outstanding May 31, 2002	244,000	$ 1.20	
Options granted	6,666	$ 1.20	
Options forfeited/cancelled	(6,677)	$ 1.20	
Options outstanding May 31, 2003	243,989	$ 1.20	
Options granted	—	$ —	
Options exercised	(56,529)	$ 1.20	
Options forfeited/cancelled	(16,944)	$ 1.20	
Options outstanding May 31, 2004	170,516	$ 1.20	6.60 Years
Options vested at May 31, 2004	138,051	$ 1.20	6.60 Years

NOTE 11

OTHER COMPREHENSIVE INCOME (LOSS)

	Years ended May 31, 2004	2003	2002
Significant components of net (loss) income:			
Write-down of long-term investment to fair market value	$ (6,800)	$ (612,200)	$ (1,516,000)
Inventory write-downs	—	(401,673)	—
Increase in reserve for deferred tax asset	—	(636,006)	—
Reserve for doubtful accounts	(8,490)	(24,060)	—
Income (loss) from operations exclusive of inventory write-downs, restructure costs increase in reserve for deferred tax asset and reserve for doubtful accounts	531,875	186,808	(82,619)
Net income (loss)	516,585	(1,487,131)	(1,598,619)
Other comprehensive (loss) income:			
(Decrease) in fair market value of long-term investment, net of taxes	—	—	(128,000)
Foreign currency translation adjustment	(95,886)	(87,616)	111,207
Total comprehensive income (loss)	$ 420,699	$ (1,574,747)	$ (1,615,412)

The long-term investment is considered an "Available-for-sale security". As required under Statement of Financial Accounting Standards No. 115, all unrealized gains and losses, net of tax benefits, are reported in Accumulated Other Comprehensive (Loss) Income and included as a separate component of Other Comprehensive (Loss) Income in Stockholders' Equity until realized or until unrealized losses are deemed to be "other than temporary". The cumulative translation adjustment consists of unrealized gains/losses from translation adjustments on intercompany foreign currency transactions that are of a long-term investment nature.

NOTE 12

EARNINGS PER SHARE

Basic earnings per share is computed using the weighted average number of shares outstanding. Diluted earnings per share is computed using the weighted average number of shares outstanding, adjusted for dilutive incremental shares attributed to outstanding options to purchase common stock. The following table is a reconciliation of the numerators and denominators of the basic and diluted per share computations for each of the three years in the period ended May 31, 2004:

	Income (Numerator)	Weighted Average Shares (Denominator)	Per Share Amount
Year ended May 31, 2004			
Basic earnings per share			
Income available to common stockholders	$ 516,585	2,438,895	$ 0.21
Effect of dilutive securities stock options	—	85,155	
Diluted earnings per share			
Income available to common stockholders	$ 516,585	2,524,050	0.20
Year ended May 31, 2003			
Basic and diluted loss per share			
Loss available to common stockholders	$ (1,487,131)	2,467,651	$ (0.60)
Year ended May 31, 2002			
Basic and diluted loss per share			
Loss available to common stockholders	$ (1,598,619)	2,488,458	$ (0.64)

In Fiscal 2003 and 2002, 243,290 and 380,142 incremental shares were excluded from the diluted loss per share calculation, as their effect was anti-dilutive.

SUMMARIZED QUARTERLY FINANCIAL DATA

In thousands, except per share information
(unaudited)

2004 Quarter Ended		**August 31**		**November 30**		**February 29**		**May 31**
Sales	$	1,648	$	1,736	$	1,773	$	2,768
Gross Profit	$	884	$	930	$	979	$	1,726
Net (Loss) income	$	(67)	$	47	$	1	$	536
Net (Loss) income Per Share, Basic	$	(.03)	$	.02	$	.00	$	.22
Net (Loss) income Per Share, Diluted	$	(.03)	$	.02	$	.00	$	.22
Market Price of Common Stock								
High	$	1.80	$	2.52	$	2.60	$	2.58
Low	$	1.24	$	1.60	$	1.91	$	1.75

2003 Quarter Ended		**August 31**		**November 30**		**February 28**		**May 31**
Sales	$	2,001	$	1,794	$	1,621	$	2,004
Gross Profit	$	1,153	$	1,049	$	462	$	1,165
Net (Loss) income	$	55	$	33	$	(1,715)	$	140
Net (Loss) income Per Share, Basic	$	.03	$	.01	$	(.69)	$	.05
Net (Loss) income Per Share, Diluted	$	.03	$	.01	$	(.69)	$	.05
Market Price of Common Stock								
High	$	1.65	$	1.95	$	1.50	$	1.60
Low	$	1.05	$	1.11	$	1.07	$	0.80

Report of Independent Registered Public Accounting Firm:

Board of Directors and Shareholders
Schmitt Industries, Inc.

We have audited the accompanying consolidated balance sheet of Schmitt Industries, Inc. and its subsidiaries as of May 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the two years in the period ended May 31, 2004. 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 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards 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. 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 audit provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Schmitt Industries, Inc. and its subsidiaries as of May 31, 2004 and 2003, and the consolidated results of their operations and their consolidated cash flows for each of the two years in the period ended May 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP

Portland, Oregon
July 27, 2004

Report of Independent Registered Public Accounting Firm:

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

In our opinion, the accompanying consolidated statements of operations, of changes in shareholders' equity and of cash flows present fairly, in all material respects, the results of Schmitt Industries, Inc. (The "Company") and its subsidiaries' operations and cash flows for the year ended May 31, 2002, in conformity with accounting principles generally accepted in the United States of America. 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 auditing standards of the Public Company Accounting Oversight Board (United States). Those standards 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 our opinion.

PricewaterhouseCoopers LLP

Portland, Oregon
July 3, 2002

ITEM 9A. CONTROLS AND PROCEDURES

(a) Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d – 15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on their evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report.

(b) There have been no changes in our internal controls that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART III

Certain information required by Part III is included in the Company's definitive Proxy Statement for its 2004 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.

Items 10 and 11. Directors and Executive Officers of the Registrant and Executive Compensation

The information required by these items is included in the Proxy Statement under the headings "Management", "Equity Compensation Plan," "Executive Compensation," "Summary Compensation Table," "Options Grants in Fiscal 2004," "Aggregated Option Expenses in Fiscal 2004 and Fiscal Year-End Option Values," and "Section 16(a) Beneficial Ownership Reporting Compliance" and "Code of Ethics" 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 "Security Ownership of Certain Beneficial Owners" and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

The information required by this item is included in the Proxy Statement under the heading “Certain Relationships and Related Transactions” and is incorporated herein by reference.

Item 14 Principal Accounting Fees and Services

The information required by this item is included in the Proxy Statement under the heading “Independent Public Accountants” and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) Financial Statements:

(1) Consolidated Balance Sheets as of May 31, 2004 and 2003

Consolidated Statements of Operations for the years ended May 31, 2004, 2003 and 2002

Consolidated Statements of Changes in Stockholders’ Equity for the years ended May 31, 2004, 2003 and 2002

Consolidated Statements of Cash Flows for the years ended May 31, 2004, 2003 and 2002

Notes to Consolidated Financial Statements

Report of Registered Public Accounting Firms

(2) *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.

(3) *Exhibits:* Reference is made to the list on page 37 of the Exhibits filed with this report.

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 11, 2004

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 11, 2004.

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/ Maynard Brown Maynard Brown	Director
/s/ Timothy D.J. Hennessy Timothy D.J. Hennessy	Director
/s/ Trevor Nelson Trevor Nelson	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, 1999
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, 1999
*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, 1999
**14.1	Code of Ethics and Business Conduct of Schmitt Industries, Inc.
**21.1	Subsidiaries of Schmitt Industries, Inc.
**23.1	Consent of Grant Thornton LLP
**23.2	Consent of PricewaterhouseCoopers LLP
**31.1	Certification of Principal Executive Officer pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
**31.2	Certification of Principal Financial Officer pursuant to 18 U.S. C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
**32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002

*Management contract or compensatory plan.

**Filed herewith

EXHIBIT 14.1

Code of Ethics and Business Conduct of Schmitt Industries, Inc.

Introduction

This Code of Ethics and Business Conduct and Ethics ("Code") sets forth the policies of Schmitt Industries, Inc. ("Schmitt", "we", or the "Company") with respect to the way we and our subsidiaries conduct ourselves individually and operate our business. The provisions of this Code are designed to promote honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships. All employees, officers and directors of the Company must comply with the provisions of this Code. References to employees contained in this Code should be understood as referring to officers and directors as well, regardless of whether such officers and directors have an employment relationship with us.

In the course of performing our various roles in the Company, each of us will encounter ethical questions in different forms and under a variety of circumstances. Moments of ethical uncertainty may arise in our dealings with fellow employees, with customers, or with other parties such as government entities or members of our community. Our employees should never be content with simply obeying the letter of the law, but must also strive to comport themselves in an honest and ethical manner. This Code provides rules and procedures to help our employees, officers and directors recognize and respond to situations that present ethical issues. For guidance with respect to issues not addressed in this Code, employees are directed to our Employee Manual which sets forth the Company's policies on a wide range of issues that arise in the course of employment.

Schmitt's reputation is its greatest asset and its value relies on the character of its employees. In order to protect this asset, Schmitt will not tolerate unethical behavior by employees, officers or directors. Those who violate the standards in this Code will be subject to disciplinary action. If you are concerned about taking an action that may violate this Code or are aware of a violation by another employee, follow the guidelines set forth in this Code.

Compliance with Laws, Rules and Regulations

Company policy requires that all employees of the Company comply fully with both the spirit and the letter of all laws, rules and regulations. Whenever an applicable law, rule or regulation is unclear or seems to conflict with either another law or any provision of this Code, all employees are urged to seek clarification from their supervisor, the Ethics Officer (identified below), or our outside legal counsel.

Conflicts of Interest

Every employee has a primary business responsibility to the Company and must avoid conflicts of interest. A conflict of interest arises when an employee takes actions or enters into relationships that oppose the interests of Schmitt or interfere with the employee's performance or independent judgment when carrying out his or her duties. The Company strictly prohibits its employees from taking any action or entering into any relationship that creates, or even appears to create, a conflict of interest without the prior approval of a supervisor. The Company's chief executive officer and chief financial officer must receive approval of our board of directors (the "Board") or a Board committee prior to taking any action or entering into any relationship that creates, or even appears to create, a conflict of interest. For purposes of determining whether a conflict exists, the actions of an employee's immediate family members are treated as those of the employee and are therefore subject to the same considerations.

In order to avoid such conflicts, an employee may not receive any payments, compensation, or gifts, other than gifts of nominal value, from any entity that does business or seeks to do business with Schmitt. Furthermore, employees may not use Company property, information or influence or their position in the Company for improper personal gain. Employees must be sensitive to other potential conflicts of interest that may arise and use their best efforts to avoid the conflict.

If an employee has any questions regarding the Company's policy on conflicts of interest or need assistance in avoiding a potential conflict of interest, he or she is urged to seek the advice of a supervisor or the Ethics Officer. <u>Our Ethics Officer is our Chief Financial Officer.</u>

Fair Dealing

Although our prosperity depends on our ability to outperform our competitors, we are committed to achieving success by fair and ethical means. We seek to maintain a reputation for honesty and fair dealing among our competitors and the public alike. In light of this aim, the Company prohibits employees from engaging in any dishonest, unethical or illegal business practices. An exhaustive list of unethical practices cannot be provided. Instead, the Company relies on the judgment of each individual employee to avoid such practices. Furthermore, each employee should endeavor to deal fairly with the Company's customers, suppliers, competitors and employees. No employee should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other unfair business practice.

Books and Records, Accounting Controls and Disclosures

The Company requires that all its books and records be maintained accurately, timely, consistently, and completely, and be prepared with honesty. This requires that no fund, asset, liability, revenue or expense be concealed or incompletely recorded for any purpose. All entries must be supported by documentation adequate to permit the books and records to be verified by audit. Proper accounting requires not only careful compliance by the Company's accountants, but also the cooperation of all employees who are involved in keeping or providing information supporting financial records of any type.

The Company's internal review processes and external independent auditing processes are essential to the proper reporting of the Company's financial information. The Audit Committee of our Board has the responsibility to review the Company's policies and practice with respect to financial reporting. By conducting this review, the Audit Committee directs management of the Company to correct deficiencies in its practices. Auditors shall have unrestricted access to all Company documents and records. All employees are required to cooperate fully with internal and external audits. In no case may an employee make a false or misleading statement to any internal or external auditor, withhold records, or otherwise interfere with an audit. An employee who has knowledge of any unreported or improperly reported financial activity must report such information to a supervisor, the Ethics Officer or the Audit Committee.

The Company recognizes that the investment community derives information regarding the Company's financial condition primarily from the Company's filings with the Securities and Exchange Commission. To promote the transparency of its financial operations, the Company has a strict policy requiring that all filings with the Securities and Exchange Commission be fairly stated, accurate, timely, consistent, and complete.

Waivers

The Company expects all employees to comply with the provisions of this Code. Any waiver of this Code for executive officers or directors may be made only by formal action of the Board and will be promptly disclosed to the public as required by law and the Nasdaq rules. When necessary, a waiver will be accompanied by appropriate controls designed to protect the Company.

Compliance Resources

In some situations, an employee may be uncertain how to proceed in compliance with this Code. This uncertainty may concern the ethical nature of the employee's own acts or the employee's duty to report the unethical acts of another. When determining the proper course of action, the employee should carefully analyze the situation and seek guidance from his or her supervisor or other appropriate personnel in accordance with the following four steps:

1. *Gather all the facts*. Do not take any action that may violate this Code until you have gathered all the facts that are required to make a well-informed decision and, if necessary, you have consulted with your supervisor, the Ethics Officer or our outside counsel.

2. *Consider whether the action is illegal or contrary to this Code*. If the action is illegal or contrary to the provision of this Code, you should not carry out the act. If you believe that this Code has been violated by an employee, you must promptly report the violation in accordance with the procedures set forth below.

3. *Discuss the problem with your supervisor*. It is your supervisor's duty to assist you to comply with this Code. Feel free to discuss the situation with your supervisor if you have any questions. You will suffer no retaliation for seeking such guidance.

4. *If necessary, seek additional resources*. The Ethics Officer is available to speak with you about problematic situations if you do not feel comfortable approaching your direct supervisor. Alternatively, you may also request assistance in writing by sending a request to the Ethics Officer. The Company's outside legal counsel is also available to assist you in complying with those aspects of the Code that involve more complex issues, such as insider trading and conflicts of interest.

Reporting Procedures

All employees have a duty to report any violations of this Code, as well as violations of any laws, rules, or regulations. Employees also have a duty to report any transaction or relationship that could reasonably be expected to give rise to a conflict of interest.

If you are aware of a potential conflict of interest or believe that the Code has been violated by an employee you must promptly report the violation to his or her direct supervisor or the Ethics Officer. If a report is made to a supervisor, the supervisor must in turn report the violation to the Ethics Officer or the CEO. All violations by an officer or director of the Company must be reported directly to the Ethics Officer or CEO. Employees may also choose to report any violations regarding record keeping or financial reporting to the Audit Committee. Reports may be made in person, by telephone, or in writing by sending a description of the violation and the names of the parties involved to the appropriate persons:

- Correspondence addressed to our Chief Financial Officer/Ethics Officer, Chief Executive Officer or Audit Committee may be sent to the following location:

  Schmitt Industries, Inc.
  2765 N.W. Nicolai Street
  Portland, Oregon 97210
  Phone: (503) 227-7908
  Fax: (503) 223-1258

- Correspondence to our outside legal counsel may be sent to the following location

  Holland & Knight LLP
  Attn: Mark A. von Bergen
  111 S.W. Fifth Avenue
  2300 U.S. Bancorp Tower
  Portland, Oregon 97204
  Phone: (503) 243-2300
  Fax: (503) 241-8014

When reporting a violation, you may choose to remain anonymous. However, if you make an anonymous report, you should create and preserve your own record of this report in order to be able to demonstrate your compliance with the requirement of reporting violations. Generally speaking, every effort will be made to maintain the confidentiality of reports of potential violations. However, there may be a point where the identity of the reporting employee may become known or may have to be revealed in the course of the investigation or to take corrective action.

The Company does not permit retaliation of any kind against employees for good faith reports of ethical violations. Any employee who attempts to or encourages others to retaliate against an individual who has reported a violation will be subject to disciplinary action.

Disciplinary Action

The Company has implemented the following disciplinary policies to ensure that prompt and consistent actions are taken in response to Code violations:

1. *Range of Penalties*. All violations of this Code will be treated seriously and will result in the prompt imposition of penalties which may include (1) an oral or written warning, (2) a reprimand, (3) suspension, (4) termination and/or (5) restitution. Violations will also be reported to the appropriate regulatory agencies or other authorities.

2. *Disciplinary Process*. The penalty for a particular violation will be decided on a case-by-case basis and will depend on the nature and severity of the violation as well as the employee's history of non-compliance and cooperation in the disciplinary process. Significant penalties will be imposed for violations resulting from intentional or reckless behavior. Penalties may also be imposed when an employee fails to report a violation due to the employee's indifference, deliberate ignorance or reckless conduct. Where there is credible evidence of a violation, the Ethics Officer, the CEO, the Audit Committee, or the Board will determine the appropriate sanction. The process will begin with the Ethics Officer and will be escalated to the level which is appropriate for the position of the person and significance of the matters which appear to be involved.

3. *Consistent Enforcement*. All employees, officers and directors will be treated equally with respect to the imposition of disciplinary measures. Pursuant to this policy, all levels of employees will be subject to the same disciplinary action for the commission of a similar offense.

EXHIBIT 21.1

SUBSIDIARIES OF SCHMITT INDUSTRIES, INC.
AS OF MAY 31, 2004

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

EXHIBIT 23.1

CONSENT OF REGISTERED PUBLIC ACCOUNTING FIRM

We have issued our report dated July 9, 2004, accompanying the financial statements included in the Annual Report of Schmitt Industries, Inc. on Form 10-K for the year ended May 31, 2004. We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-3910).

Grant Thornton LLP

Portland, Oregon
August 10, 2004

EXHIBIT 23.2

CONSENT OF REGISTERED PUBLIC ACCOUNTING FIRM

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 3, 2002 relating to the Fiscal 2002 financial statements, which appears in this Form 10-K.

PricewaterhouseCoopers LLP

Portland, Oregon
August 10, 2004

EXHIBIT 31.1

CERTIFICATION PURSUANT TO
18 U.S. C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Wayne A. Case, certify that:

1. I have reviewed this annual report on Form 10-K of Schmitt Industries, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 11, 2004 /s/ Wayne A. Case

Wayne A. Case, President/CEO/Director

EXHIBIT 31.2

CERTIFICATION PURSUANT TO
18 U.S. C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Robert C. Thompson, certify that:

1. I have reviewed this annual report on Form 10-K of Schmitt Industries, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 11, 2004 /s/ Robert C. Thompson

Robert C. Thompson, Chief Financial Officer/Treasurer

Exhibit 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Schmitt Industries, Inc. (the “Company”) on Form 10-K for the Fiscal year ended May 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), we, Wayne A. Case and Robert C. Thompson, Chief Executive Officer and Chief Financial Officer, respectively, of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to our knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Wayne A. Case
Chief Executive Officer
August 11, 2004

Robert C. Thompson
Chief Financial Officer
August 11, 2004