

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, 2020

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: 001-38964

SCHMITT INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Oregon
(State or other jurisdiction of
incorporation or organization)

93-1151989
(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	Trading Symbol(s)	Name of each exchange on which registered
Common Stock – no par value	SMIT	NASDAQ Capital Market
Series A Junior Participating Preferred Stock Purchase Rights		

Securities registered pursuant to Section 12(g) of the Act:
None

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

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

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 whether the registrant has submitted electronically and posted on its Corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Large accelerated filer
Smaller reporting company

Accelerated filer
Emerging growth company

Non-accelerated filer

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

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

As of the last day of the second Fiscal quarter of 2020, the aggregate market value of registrant's common stock held by non-affiliates of the registrant was approximately \$8,802,684 based upon the closing price of \$3.66 reported for such date on the NASDAQ Capital Market. As of July 31, 2020, the registrant had 3,712,927 outstanding shares of Common Stock.

Documents Incorporated by Reference

Portions of the registrant's definitive Proxy Statement for its 2020 Annual Meeting of Shareholders are incorporated by reference into Part III hereof.



SCHMITT INDUSTRIES, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED MAY 31, 2020

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PART I

Cautionary Note Regarding Forward-Looking Statements

Certain statements contained in this report are forward-looking in nature. Words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “sees,” “estimates” and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. Certain of such risks and uncertainty are discussed in the “Risk Factors” section in Item 1A.

ITEM 1. BUSINESS

Schmitt Industries, Inc. (the “Company”) was founded in 1987. As a leader in precision testing and measurement products, Schmitt helps customers save money, increase production efficiency and improve product quality across a variety of industries.

The Company’s current family of products includes the Acuity™ and Xact™ product lines.

Acuity products utilize both triangulation and time-of-flight measurement principles and are known for their speed and accuracy. Acuity products are used in a wide variety of industrial, commercial and research applications.

Xact ultrasonic measurement technology monitors the fill levels of propane and other liquid tanks via satellite-connected devices. Together with the Xact gauge reader, Xact systems can detect and communicate fill levels, along with other information such as tank size and configuration, to customers through the “Internet of Things” ecosystem using our satellite provider and a secure website. Typical users of Xact systems are bulk propane, diesel, jet fuel suppliers and ammonia users and distributors.

The Company was originally incorporated under the laws of British Columbia, Canada, in 1984 and was reincorporated under the laws of the State of Oregon in 1995. Schmitt is an ISO 9001 certified company. Schmitt trades on the Nasdaq Composite Index (the “NASDAQ”) under the ticker “SMIT”.

As discussed further in Note 10, the Company’s former SBS business line was sold to Tosei Engineering Corp on November 22, 2019. After the sale of the SBS business, based on the types of products and services sold, and an analysis of how the Company reviews and manages operations, the Company determined that it operates as one reportable segment: Measurement (“Measurement”) Segment.

As discussed further in Note 11, the Company now operates Ample Hills Creamery following the July 9, 2020 successful asset purchase of, among other things, Ample Hills’ equipment, inventory, and all intellectual property, including the names and marks of “AMPLE HILLS” and “AMPLE HILLS CREAMERY” and all derivatives thereof.

Measurement Segment

In the Measurement Segment, our measurement solutions support a wide range of industries through laser solution products, applications, and our tank monitoring products. These products and services include the Acuity and Xact product lines.

ACUITY LASERS

Acuity sells products, solutions and services including laser and white light sensor distance, measurement and dimensional sizing products.

Products and Services

Products sold under the Acuity brand include lasers utilizing both triangulation and time-of-flight methods of measurement, and confocal chromatic white light sensors. These lasers are used in a wide range of industrial applications including manufacturing, lumber production, steel casting, glass and paper production, medical imaging, crane control and micron-level part and surface inspection.

Customers and Markets

Acuity laser measurement sensors are used for fast and accurate dimensional measurement in a wide range of applications, including factory automation, surface profile scanning, crane positioning, road profiling, tire production, semiconductor manufacturing and many other industrial and commercial applications.

The market for Acuity lasers is growing as the industry moves from a products market to a solutions-based market as customers seek tailored solutions to solve complex problems in a range of industrial and manufacturing businesses.

Competition

The Company believes the principal elements of competition include quality of ongoing technical support and maintenance coupled with responsiveness to customer needs, as well as price, product quality, reliability and performance. The Acuity products market is extremely competitive, characterized by rapidly changing technology, and includes multinational competitors. Company pricing is intended to obtain market share and meet competitive supplier prices. The market strategy is to establish products with the best quality, reliability and performance and superior economic value.

XACT REMOTE TANK MONITORING SYSTEMS

Xact product line includes satellite focused remote tank monitoring products and related monitoring services for markets in the Internet of Things (“IoT”) environment. The products measure the fill levels of tanks holding propane, diesel and other tank-based liquids and the related monitoring services includes transmission of fill data from the tanks via satellite to a secure web site for display.

Products and Services

Xact Satellite Remote Tank Monitors include both ultrasonic and gauge reader sensors that provide remote fill level monitoring of propane, diesel and other tank-based liquids for tanks anywhere in the world. The Xact Tank Monitoring Systems are highly dependable, providing the ability to operate in a wide range of environments with temperatures ranging from -40°C to 60°C. The Xact systems can be used to monitor tanks as small as 125 gallons (473 liters) and as large as 90,000 gallons (340,686 liters). With Xact, users access timely and accurate remote tank data on a consistent schedule or by customized critical fill alarms to optimize inventory management processes.

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

Tank Sensors – Xact offers two sensors, the Xact Ultrasonic sensor and the Xact Gauge Reader.

The Xact Ultrasonic sensor incorporates patented technology and is externally mounted to the bottom of the tank with no reliance on existing mechanical gauges. The system employs a small electrical pulse, which is able to calculate the precise fill level inside using patented sonar technology (measurement accuracy to within $\pm 2\%$ for large tanks and $\pm 1\%$ for small tanks). Ultrasonic sensors work with any tank-based liquids including propane, diesel and natural gas.

The Xact gauge reader connects to the face of a float gauge and detects the fill level that is reported by the gauge. The system then transmits that data by satellite in the same manner as the Ultrasonic sensor. Float gauges have a typical accuracy range of $\pm 4\%$ to $\pm 8\%$. Gauge readers are primarily used in the propane industry to monitor propane tanks and support refill optimization for distributors and customers.

Satellite Radio Transmitter – The Xact radio transmitter is placed on the top of the tank and is connected by cable to the tank sensor or gauge reader. The transmitter transmits the tank data using the GlobalStar[®] satellite network to the secure Xact website. Xact satellite telemetry provides global coverage with no dependence on land lines, cellular networks or Wi-Fi signals, making it a reliable monitoring solution for tanks located anywhere in the world.

Xact Website – The Xact website is a secured location providing controlled access to the tank data for each customer’s various tank locations. Customers can access the website to check fill levels and additional information such as temperature, battery status, GPS coordinates and map location. In addition, the data can also be integrated into customer back-office software via API. This integration can be automatically directed to a customer’s inventory or delivery management system for full automation of the delivery process.

Customers and Markets

Accessing accurate fill level information is essential to effectively manage inventory, improve delivery efficiency, reduce operating costs and increase profitability, and justify capital expenditures for fuel providers. Xact focuses on niche satellite solutions, which separates it from intense competition in the cellular monitoring industry. To reach our customers and fill gaps in cellular monitor customers, Xact partners with select cell providers in providing our Xact solution. Given our niche market, Xact is well positioned to partner with various providers to offer a full range solution.

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

Competition

Competitors offer telemetry options based on cellular or closed-loop communication networks, whereas Xact telemetry is satellite based. General tank monitoring competitors include: Anova (Wesroc), NasCorp (SkyTracker), WACnGO, Silicon Controls, TankScan, SkyBitz, Otodata, Angus Energy (Gremlin), and Tank Utility. Competitors that offer satellite telemetry include Anova (WESROC), NasCorp (SkyTracker), and Micro-Design, Inc. (LevelCon).

Business and Marketing Strategy

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

Measurement Segment Products

The Measurement segment uses a variety of methods to market and sell its products. Primarily, our sales and marketing managers direct the overall worldwide sales and marketing efforts for the Acuity and Xact products, including the employment and management of representatives and distributors in various markets.

Backlog

Backlog is not a reliable indicator of Company performance. Normally, orders are shipped within one to three weeks after receipt unless the customer requests otherwise.

Manufacturing

The Company uses a variety of sources for the supply of raw materials for the product lines. Essential electronic components, available in large quantities from various suppliers, are assembled electronic control units under the Company's quality and assembly standards. Company-owned software and firmware are coupled with the electronic components to provide the basis of the Company's various electronic control units. Management believes several supply sources exist for all electronic components and assembly work incorporated into its electronic control systems. Mechanical parts for the Company's products are produced by high quality machine shops. The Company is not dependent on any one supplier of mechanical components. In the event of supply problems, the Company believes that two or three alternatives could be developed within 30 days. The Company is subject to availability and pricing on the various component parts purchased, which has had, and may continue to have, a material impact on operations.

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

The Company's Quality Control Program first received full ISO 9001 certification in 1996. In 2005, the Company received its certification to the newer ISO 9001:2000 requirements and received subsequent recertification and is current as of Fiscal year end 2020 with ISO 9001:2015 requirements.

Proprietary Technology

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

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

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

Product Development

The Company maintains an ongoing research and development program to expand the product lines and capabilities of its business segments. During Fiscal 2020 and 2019, the Company's research and development expense totaled \$68,847 and \$56,833, respectively.

Employees

As of May 31, 2020, the Company employed 18 individuals, none of which were covered by a collective bargaining agreement.

ITEM 1A. RISK FACTORS

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

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

The Company's operations and performance depend significantly on worldwide economic conditions, particularly in the industrial and manufacturing sectors, and their impact on levels of capital spending. Economic factors that could adversely influence demand for the Company's products include uncertainty about global economic conditions leading to reduced levels of investment, reduction in demand for our customers' products, customers' and suppliers' access to credit and the stability of the global financial system, the overall health of our markets, unemployment and other macroeconomic factors generally affecting commercial and industrial spending behavior.

Past distress in the global financial markets and global economy resulted in reduced liquidity and a tightening of credit markets. If these conditions were to reoccur, the Company could experience several potential adverse effects, including the inability of customers to obtain credit to finance purchases of the Company's products, the insolvency of customers resulting in reduced revenues and bad debts, and the insolvency of key suppliers resulting in product development and production delays.

The Company's primary markets are volatile and unpredictable.

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

Technological advancement and potential competition.

The failure to develop new products or enhance existing products or react to changes in existing technologies could result in decreased revenues and a loss of market share to competitors.

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

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

The Company may experience increased pricing pressure.

We have experienced and may continue to experience pricing pressure in the sale of our products, from both competitors and customers. Our business, financial condition, margins or results of operations may be materially and adversely affected by competitive pressure and intense price-based competition.

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 could be adversely affected if adequate supplies of raw materials cannot be obtained in a timely manner or if raw material costs increase significantly.

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

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

The Company maintains a significant investment in inventories in anticipation of future revenues.

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

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

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

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

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

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

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

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

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

Failure to protect our technology systems from cybersecurity occurrences may have an adverse effect on the Company's operations.

As part of operations management, we use information technologies for various business functions, including; data processing, data store, and to communication amongst personnel, customers and suppliers. Further, we use information technologies to process financial information and results of operations for internal reporting purposes and to comply with regulatory, legal and tax requirements. We rely on third party providers for some of these information technologies and support.

Despite our security design and controls and other operational safeguards, and those of our third party providers, our information technology systems may be vulnerable to a variety of interruptions, including during the process of upgrading or replacing hardware, software, databases or components thereof, natural disasters, terrorist attacks, telecommunications failures, computer viruses, cyber-attacks, hackers, unauthorized access attempts and other security issues or may be breached due to employee error, malfeasance or other disruptions. Such occurrences could result in operational disruptions or the misappropriation of data that could subject our organization to civil and criminal penalties, litigation or have a negative impact on our reputation.

Many of our information technology systems also contain proprietary and other confidential information related to our business, such as business plans and research and development initiatives. Failure to protect existing intellectual property rights may result in the loss of valuable technologies or paying other companies for infringing on their intellectual property rights. The Company relies on patent, trade secret, trademark and copyright law to protect such technologies. There is no assurance any of the Company's U.S. patents will not be invalidated, circumvented, challenged or licensed to other companies.

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

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

Pandemics or disease outbreaks, such as the current novel coronavirus (COVID-19 virus) pandemic may disrupt our business, which could materially affect our operations and results of operations.

Pandemics or disease outbreaks such as the COVID-19 pandemic, have and may continue to impact customer traffic at Company-owned locations, may make it more difficult to staff our Company-owned locations, and, in more severe cases, may cause a temporary inability to obtain supplies, increase commodity costs or continue to cause full and partial closures of our affected Company-owned locations, sometimes for prolonged periods of time. [The Company has implemented closures, modified hours or reductions in on-site staff, resulting in cancelled shifts for some of the Company employees.] These changes and any additional changes may materially adversely affect our business or results of operations, and may impact our liquidity or financial condition, particularly if these changes are in place for a significant amount of time. In addition, our operations could be disrupted if any of our employees or employees of the Company's suppliers and business partners were or are suspected of having COVID-19 or other illnesses since this could require the Company, its suppliers or its business partners to quarantine some or all such employees, close and disinfect locations and other facilities or, in the case of our suppliers, delay in delivering the Company's products. If a significant percentage of the Company's workforce, our suppliers and business partners are unable to work, including because of illness or travel or government restrictions in connection with pandemics or disease outbreaks (including the current COVID-19 pandemic), the Company's operations may be negatively impacted, potentially materially adversely affecting the Company's business, liquidity, financial condition or results of operations. Furthermore, such viruses may be transmitted through human contact, and the risk of contracting viruses has caused and could continue to cause employees or guests to avoid gathering in public places, which has had, and could further have, adverse effects on guest traffic at our locations or the ability to adequately staff locations. The Company could also be adversely affected if government authorities continue to impose restrictions on public gatherings, human interactions, operations of businesses or mandatory closures, seek voluntary closures, restrict hours of operations or impose curfews, restrict the import or export of products or if suppliers issue mass recalls of products. Currently, several states and municipalities in the U.S. and abroad have temporarily suspended the operation of dining in at restaurants and instituted restrictions on public gatherings in light of COVID-19 which has caused venues such as professional sports venues, amusement parks, shopping malls and movie theaters to close temporarily. Additional regulation or requirements with respect to the compensation of the Company's employees and the employees of our business partners could also have an adverse effect on the Company's business. The implementation of such measures and if the virus or other disease continues to spread significantly, the perceived risk of infection or health risk may adversely affect the Company's business, liquidity, financial condition and results of operations.

Our results of operations could in the future be materially adversely impacted by coronavirus pandemic (COVID-19).

The global spread of the coronavirus (COVID-19) has created significant volatility and uncertainty and economic disruption. The extent to which the coronavirus pandemic impacts our business, operations and financial results will depend on numerous evolving factors that we may not be able to accurately predict, including: the duration and scope of the pandemic; governmental, business and individuals' actions that have been and continue to be taken in response to the pandemic; the impact of the pandemic on economic activity and actions taken in response; the effect on our customers and customer demand for our products, solutions, and services; our ability to sell and provide our products, solutions, and services, including as a result of travel restrictions and people working from home; the ability of our customers to pay for our products, solutions, and services; and any closures of our and our customers' offices and facilities. Clients may also slow down decision making, delay planned work or seek to terminate existing agreements. Any of these events could cause or contribute to the risks and uncertainties enumerated in the Annual Report and could materially adversely affect our business, financial condition, results of operations and/or stock price.

We have identified a material weakness in our internal control over financial reporting which could, if not remediated, result in material misstatements in our financial statements.

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. As disclosed in Item 9A, management identified a material weakness in our internal control over financial reporting related to the financial reporting cycle.

A material weakness is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. As a result of this material weakness, our management concluded that our internal control over financial reporting was not effective. We are actively engaged in developing a remediation plan designed to address this material weakness. If our remedial measures are insufficient to address the material weakness, or if additional material weaknesses or significant deficiencies in our internal control are discovered or occur in the future, our consolidated financial statements may contain material misstatements and we could be required to restate our financial results.

Risks Related to Ample Hills

We may be subject to and adversely affected by claims that were not properly discharged in the Bankruptcy Court order authorizing the Ample Hills Transactions, amounts that we may owe in connection with the Transactions, an inability to recover amounts owed to us in connection with the Transactions or other post-bankruptcy operational risks.

Notwithstanding the terms of the Bankruptcy Court order dated July 9, 2020 authorizing and approving the Ample Hills Transactions, a creditor (including any governmental agency) of Ample Hills may attempt to assert against us or the assets we acquired an existing lien, claim, interest, or encumbrance. Circumstances in which such claims and obligations that arose prior to the Bankruptcy Court order may not have been properly discharged include, but are not limited to, instances where a claimant had inadequate notice of the bankruptcy filing. In addition, the Ample Hills Agreement does not provide for indemnification of losses or liabilities we may incur as a result of the Transactions. Accordingly, we may not be compensated for losses we may suffer as a result of the foregoing.

Notwithstanding the terms of the Bankruptcy Court order or the applicable provisions of the United States Bankruptcy Code, it is possible that parties-in-interest in the Ample Hills bankruptcy may later attempt to challenge the terms or validity of the Transactions.

Our strategy to increase our growth through acquisitions may be unsuccessful and could adversely affect our business and results.

As part of our growth strategy, we intend to further acquire other businesses; however, there is no assurance that we will be able to identify appropriate acquisition targets, successfully acquire identified targets or successfully integrate the business of acquired companies to realize the full benefits of the combined businesses.

While we recently acquired Ample Hills in connection with our growth strategy to acquire other businesses, we can provide no assurance that we will identify appropriate acquisition targets, successfully complete any future acquisitions or successfully integrate the business of companies we do acquire. Even if we successfully acquire a business entity, there is no assurance that our combined business will become profitable. The process of completing the integration of acquired businesses could cause an interruption of, or loss of momentum in, the activities of our company and the loss of key personnel. The diversion of management's attention and any delays or difficulties encountered in connection with the pursuit of business acquisitions and the integration of acquired businesses, and the incurrence of significant, acquisition related costs in connection with proposed and completed acquisitions, could have an adverse effect on our business, financial condition or results of operations.

We may not be able to achieve the anticipated synergies and benefits from business acquisitions.

Acquisitions, including the Ample Hills Transactions, involve many complexities, including, but not limited to, risks associated with the acquired business' past activities, loss of customers, regulatory changes that are not anticipated, difficulties in integrating personnel and human resource programs, integrating accounting systems and other infrastructures, general underperformance of the business under our control versus the prior owners, unanticipated expenses and liabilities, and the impact on its internal controls of compliance with the regulatory requirements under the Sarbanes-Oxley Act of 2002. There is no guarantee that our acquisitions will increase the profitability and cash flow of the Company, and its efforts could cause unforeseen complexities and additional cash outflows, including financial losses. As a result, the realization of anticipated synergies or benefits from acquisitions may be delayed or substantially reduced, and could potentially result in the impairment of its investment in these businesses.

If the benefits of any completed or proposed acquisition do not meet the expectations of investors, stockholders or financial analysts, the market price of our common stock may decline.

If the benefits of any completed acquisition (including Ample Hills) or proposed acquisition do not meet the expectations of investors or securities analysts, the market price of our common stock prior to such acquisition may decline. The market values of our common stock at the time of an acquisition may vary significantly from their prices on the date the acquisition target was identified.

Increases in the cost of food and paper products could harm our profitability and operating results.

The cost of the food and paper products we use depends on a variety of factors, many of which are beyond our control. We are unable to predict the future cost of our ice cream and expect to experience price volatility for our ice cream products during fiscal 2021. To the extent that dairy prices increase as compared to earlier periods, it could impact our results of operations. If the price of dairy or other food products that we use in our operations significantly increases, or tariffs are imposed, and we choose not to pass, or cannot pass, these increases on to our customers, our operating margins will decrease and such decrease in operating margins could have a material adverse effect on our business, results of operations or financial condition.

Fluctuations in weather, supply and demand and economic conditions could adversely affect the cost, availability and quality of some of our critical products, including dairy. Our inability to obtain requisite quantities of high-quality ingredients would adversely affect our ability to provide the menu items that are central to our business, and the highly competitive nature of our industry may limit our ability to pass through increased costs to our customers. Continuing increases in the cost of fuel would increase the distribution costs of our prime products thereby increasing the food and paper cost to us, thus negatively affecting profitability.

The retail business of the foodservice industry is highly competitive, and that competition could lower revenues, margins and market share.

The retail business of the foodservice industry is intensely competitive regarding price, service, location, personnel and type and quality of product. We compete with international, national, regional and local retailers primarily through the quality, variety and value perception of the products offered. Other key competitive factors include the number of locations, quality and speed of service, attractiveness of facilities, effectiveness of advertising and marketing programs, and new product development. We anticipate competition will continue to focus on convenience and pricing. Many of our competitors have substantially larger marketing budgets, which may provide them with a competitive advantage. Changes in pricing or other marketing strategies by these competitors can have an adverse impact on our sales, earnings and growth. Extensive price discounting in the retail business of the foodservice industry could have an adverse effect on our financial results.

In addition, we compete within the foodservice market and the retail business not only for customers but also for management and hourly employees. If we are unable to maintain our competitive position, we could experience downward pressure on prices, lower demand for products, reduced margins, the inability to take advantage of new business opportunities and the loss of market share.

Any perceived or real health risks related to the food industry could adversely affect our ability to sell our products.

We are subject to risks affecting the food industry generally, including risks posed by the following; food spoilage, contamination, or product tampering, consumer product liability claims, and potential cost and disruption of a product recall.

Our products are susceptible to contamination by disease-producing organisms, or pathogens, such as listeria monocytogenes, salmonella, campylobacter, hepatitis A, trichinosis and generic E. coli. Because these pathogens are generally found in the environment, there is a risk that these pathogens could be introduced to our products as a result of improper handling at the manufacturing, processing, foodservice or consumer level. Our suppliers' manufacturing facilities and products, as well as our Company operations, are subject to extensive laws and regulations relating to health, food preparation, sanitation and safety standards. Difficulties or failures by these companies in obtaining any required licenses or approvals or otherwise complying with such laws and regulations could adversely affect our revenue that is generated from these companies. Furthermore, we cannot assure you that compliance with governmental regulations by our suppliers or in connection with the Company's operations will eliminate the risks related to food safety.

Events reported in the media, or food tampering, whether or not accurate, can cause damage to the Company's reputation and affect sales and profitability. Reports, whether true or not, of food-borne illnesses (such as e-coli, avian flu, hepatitis A, trichinosis or salmonella) and injuries caused by food tampering have in the past severely injured the reputations of participants in the retail business and could in the future affect our business as well. Our brand's reputation is an important asset to the business; as a result, anything that damages our brand's reputation could immediately and severely hurt system-wide sales and, accordingly, revenue and profits. If customers become ill from food-borne illnesses or food tampering, we could also be forced to temporarily close some, or all, locations. In addition, instances of food-borne illnesses or food tampering, even those occurring solely at the locations of competitors, could, by resulting in negative publicity about the foodservice industry, adversely affect system sales on a local, regional or system-wide basis. A decrease in customer traffic as a result of these health concerns or negative publicity, or as a result of a temporary closure of any of our Company-owned locations, could materially harm our business, results of operations and financial condition.

Additionally, we may be subject to liability if the consumption of any of our products causes injury, illness, or death. A significant product liability judgment or a widespread product recall may negatively impact our sales and profitability for a period of time depending on product availability, competitive reaction, and consumer attitudes. Even if a product liability claim is unsuccessful or is not fully pursued, the negative publicity surrounding any assertion that our products caused illness or injury could adversely affect our reputation with existing and potential customers and our corporate and brand image. Injury to the Company's reputation would likely reduce revenue and profits.

Negative publicity, including complaints on social media platforms and other internet-based communications, could damage our reputation and harm our guest traffic, and in turn, negatively impact our business, financial condition, results of operations and prospects.

There has been a marked increase in the use of social media platforms and similar devices, including blogs, social media websites and other forms of internet-based communications that allow individuals to access a broad audience of consumers and other interested persons. Consumers value readily available information concerning goods and services that they have or plan to purchase, and may act on such information without further investigation or authentication. The availability of information on social media platforms is virtually immediate, as is its impact. Many social media platforms immediately publish the content their subscribers and participants can post, often without filters or checks on accuracy of the content posted. The opportunity for dissemination of information, including inaccurate information, is seemingly limitless and readily available. Information concerning our business and products may be posted on such platforms at any time. Information posted may be adverse to our interests or may be inaccurate, each of which may harm our performance, prospects or business. The harm may be immediate without affording us an opportunity for redress or correction. Such platforms could also be used for dissemination of trade secret information, compromising valuable Company assets. In sum, the dissemination of information online, regardless of its accuracy, could harm our business, financial condition, results of operations and prospects.

Pandemics or disease outbreaks, such as the current novel coronavirus (COVID-19 virus) pandemic may disrupt our business, which could materially affect our operations and results of operations.

Pandemics or disease outbreaks such as the COVID-19 pandemic, have and may continue to impact customer traffic at Company-owned locations, may make it more difficult to staff our Company-owned locations, and, in more severe cases, may cause a temporary inability to obtain supplies, increase commodity costs or continue to cause full and partial closures of our affected Company-owned locations, sometimes for prolonged periods of time. These changes and any additional changes may materially adversely affect our business or results of operations, and may impact our liquidity or financial condition, particularly if these changes are in place for a significant amount of time. In addition, our operations could be disrupted if any of our employees or employees of the Company's suppliers and business partners were or are suspected of having COVID-19 or other illnesses since this could require the Company, its suppliers or its business partners to quarantine some or all such employees, close and disinfect locations and other facilities or, in the case of our suppliers, delay in delivering the Company's products. If a significant percentage of the Company's workforce, our suppliers and business partners are unable to work, including because of illness or travel or government restrictions in connection with pandemics or disease outbreaks (including the current COVID-19 pandemic), the Company's operations may be negatively impacted, potentially materially adversely affecting the Company's business, liquidity, financial condition or results of operations. Furthermore, such viruses may be transmitted through human contact, and the risk of contracting viruses has caused and could continue to cause employees or guests to avoid gathering in public places, which has had, and could further have, adverse effects on guest traffic at our locations or the ability to adequately staff locations. The Company could also be adversely affected if government authorities continue to impose restrictions on public gatherings, human interactions, operations of businesses or mandatory closures, seek voluntary closures, restrict hours of operations or impose curfews, restrict the import or export of products or if suppliers issue mass recalls of products. Currently, several states and municipalities in the U.S. and abroad have temporarily suspended the operation of dining in at restaurants and instituted restrictions on public gatherings in light of COVID-19 which has caused venues such as professional sports venues, amusement parks, shopping malls and movie theaters to close temporarily. Additional regulation or requirements with respect to the compensation of the Company's employees and the employees of our business partners could also have an adverse effect on the Company's business. The implementation of such measures and if the virus or other disease continues to spread significantly, the perceived risk of infection or health risk may adversely affect the Company's business, liquidity, financial condition and results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company owns three buildings in Portland, Oregon totaling approximately 40,500 square feet.

ITEM 3. LEGAL PROCEEDINGS

As of the reporting date of the annual report, there are no pending legal proceedings, that are material to the company.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

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

As of July 31, 2020, there were 3,712,927 shares of Common Stock outstanding held by 68 holders of record.

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

This table shows information about equity awards under the Company’s equity compensation plans at May 31, 2020:

Plan Category	Number of Securities to be issued upon exercise of outstanding awards (a)	Weighted-average exercise price of outstanding awards (b)	Number of Securities remaining available for future issuance under equity compensation plans (excluding securities in column a) (c)
Equity compensation plans approved by security holders	77,647	\$ 3.34	435,792
Equity compensation plans not approved by security holders	-	0.00	-
	77,647	\$ 3.34	435,792

Recent Sales of Unregistered Securities

None.

Issuer Purchases of Equity Securities

None.

ITEM 6. SELECTED FINANCIAL DATA

In thousands, except per share information

	Year-ended, May 31,	
	2020	2019
Net Sales	4,190	4,729
Net loss from continuing operations	(1,842)	(1,468)
Net loss from continuing operations per common share, basic	(0.47)	(0.37)
Weighted average number of common shares, basic	3,940	4,006
Net loss from continuing operations per common share, diluted	(0.47)	(0.37)
Weighted average number of common shares, diluted	3,940	4,006
Stockholder's Equity	11,893	8,473
Total Assets	13,201	9,865
Long-term Debt (including current portion)	-	49

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

OVERVIEW

We are a leader in precision test and measurement products, Schmitt’s family of products helps customers save money, increase production efficiency and improve product quality across a variety of industries. The Company’s family of products includes Acuity and Xact and serves a variety of industries. Schmitt trades on the NASDAQ under the ticker “SMIT”.

As described in Note 10, the Company sold the Schmitt Dynamic Balance Systems (“SBS”) business line on November 22, 2019. After the sale of the SBS business, based on the types of products and services sold, and an analysis of how the Company reviews and manages its operations, the Company determined that it operates as one segment: Measurement Segment.

RECENT DEVELOPMENTS**Strategic Highlights**

The Company entered into an agreement to sell the Schmitt Dynamic Balance Systems (“SBS”) business line to Tosei Engineering Corp. and Tosei America, Inc. for a purchase price of \$10,500,000 in cash (the “SBS Transaction”). The transaction closed on November 22, 2019 and included certain assets held by the U.S. parent company and all the outstanding stock of the UK subsidiary, Schmitt Europe Limited. As a result, the financial position, results of operations, and cash flows relating to our SBS business line are reported as discontinued operations in the accompanying financial statements.

Further, in Q1 of Fiscal year 2020, we announced that the Board of Directors adopted a stockholder rights plan in an effort to protect its net operating loss carryforwards (“NOLs”) under Section 382 of the Internal Revenue Code. Schmitt had federal and state NOLs of approximately \$5.6 million and \$6.1 million, respectively, which could be used in certain circumstances to offset Schmitt’s future taxable income or otherwise payable taxes and therefore reduce its federal and state income tax liabilities, as of May 31, 2019. Our ability to use the NOLs would be limited in the event of an “ownership change” under Section 382 of the Internal Revenue Code and related U.S. Treasury regulations. The stockholder rights plan is intended to reduce the likelihood of an unintended ownership change occurring through the buying of Schmitt common stock and was not meant to be an anti-takeover measure.

As disclosed in “Item 1. Business—Recent Developments”, the Company acquired the Ample Hills ice cream business as of July 9, 2020. Following the Transaction, Ample Hills has begun reopening retail locations, rehiring Ample Hills team members, and reopening the Red Hook ice cream factory in Brooklyn, New York. As the Transaction occurred after May 31, 2020, the results of Ample Hills are not reflected in the Company’s results but are anticipated to be a significant component of the Company’s results in subsequent periods.

Key Leadership Changes

On June 26, 2019, we announced the appointment of Steven Strom as the fifth member of the Company’s Board, effective June 21, 2019. Steven Strom is an “independent director” according to the rules of the Securities and Exchange Commission and the NASDAQ and his appointment created a majority of independent directors on the Board in compliance with NASDAQ requirements. Mr. Strom is the founder of Odinbrook Global Advisors and has more than thirty years of experience advising companies in the US, Canada, Latin America, Europe and Asia.

On August 1, 2019, we announced the appointment of Michael R. Zapata as President and Chief Executive Officer, effective July 30, 2019.

On January 15, 2020, Jamie Schmidt was appointed Chief Financial Officer of the Company.

RESULTS OF OPERATIONS

	Years ended May 31,			
	2020		2019	
Total Revenue, net	\$ 4,189,924	100.0%	\$ 4,729,442	100.0%
Cost of Sales	2,239,376	53.4%	2,960,680	62.6%
Gross Profit	\$ 1,950,548	46.6%	\$ 1,768,762	37.4%
General, administration and sales	4,061,621	96.9%	3,180,497	67.2%
Research & Development	68,849	1.6%	56,833	1.2%
Total operating expenses	4,130,470	98.6%	3,237,330	68.5%
Operating Loss	\$ (2,179,922)	-52.0%	\$ (1,468,568)	-31.1%
Other Income (expense), net	322,980	7.7%	8,919	0.2%
Loss before Income taxes	\$ (1,856,942)	-44.3%	\$ (1,459,649)	-30.9%
Provision for income taxes	(14,638)	-0.3%	8,783	0.2%
Net Loss	\$ (1,842,304)	-44.0%	\$ (1,468,432)	-31.0%

Fiscal Year Ended May 31, 2020 Compared to Fiscal Year Ended May 31, 2019

Consolidated Revenue – Consolidated revenue decreased \$539,518, or 11.4%, to \$4,189,924 in the Fiscal year ended May 31, 2020 (“Fiscal 2020”) from \$4,729,442 in the Fiscal year ended May 31, 2019 (“Fiscal 2019”).

Revenue by product line for the Measurement segment for Fiscal 2020 compared to Fiscal 2019 were as follows:

	Fiscal year ended, May 31,		Year over Year Change	
	2020	2019	\$	%
Acuity	\$ 1,673,121	\$ 2,128,136	\$ (455,015)	-21.4%
Xact - Product	825,114	1,203,893	(378,779)	-31.5%
Xact - Monitoring	1,524,210	1,367,329	156,881	11.5%
Other	167,479	30,084	137,395	456.7%
Total Measurement Segment Revenue	\$ 4,189,924	\$ 4,729,442	\$ (539,518)	-11.4%

Gross margin – In Fiscal 2020, gross margin increased to 46.6% from 37.4% in Fiscal 2019. The increase was due to a product mix shift towards higher-margin Xact monitoring revenue as a result of the growth of the monitoring revenue and the decline in sales of XACT and Acuity products. The Company also generated \$167,479 in revenue from its discontinued product line which had no associated cost of sales.

Further impacting the gross margin were inventory adjustments that decreased from \$(213,253) in Fiscal Year 2019 as compared to \$(76,099) in Fiscal Year 2020. These inventory adjustments were the outcome of management’s requirement to complete an in-depth review of the inventory, with standards of the review focused on more current turnover. These adjustments are direct charges to cost of sales and resulted in a reduction of gross margin from 41.9%, before adjustment, to 37.4% for Fiscal 2019. The remainder of the year over year change in gross margin was primarily influenced by focused efforts to reduce product costs and targeted efforts to increase prices where possible.

Operating expenses – Operating expenses increased \$893,140, or 27.6% to \$4,130,470 in Fiscal 2020 compared to \$3,237,330 in Fiscal 2019. Items that impacted operating expenses in Fiscal 2020 include:

- Increase in professional fees of \$318,934, or 28.6%, to \$1,435,035 in Fiscal 2020 as compared to \$1,116,101 in 2019. The increase was due in part to \$842,162 in turnaround and restructuring costs related to the sale of the SBS business and business planning initiatives in Fiscal 2020 as compared to \$752,481 in Fiscal 2019 for reorganization and turnaround costs.
- Decrease in commission expense in the amount of \$108,192, or 35.9%, to \$193,231 in Fiscal 2020 as compared to \$301,423 in Fiscal 2019 due to the restructuring of the Company’s sales commissions programs and a decrease in revenue.
- Increase in stock compensation expense of \$259,426, or 274.2%. The majority of the stock compensation was due to issuance and vesting of performance based Restricted Stock Units.
- Accrued taxes at year end were \$265,349 as of Fiscal Year end May 31, 2020 as compared to \$0 as of Fiscal Year end 2019. The increase is related to a tax accrual booked to reserve for estimated tax liabilities.
- Increase in bad debt expense in the amount of \$64,106, or 383.6%, to \$80,818 in Fiscal 2020 as compared to \$16,712 in Fiscal 2019. The increase is primarily due to a change in reserve policy, where the company now reserves for 100% of customer balances over 90 days. The slow payment of customers is also related to the impacts of COVID-19.

Other income (expense) – Other income (expense) consists of rent income, interest income and expense, foreign currency exchange gain (loss) and other income (expense). Rental income for Fiscal 2020 increased \$187,664, due to rent collected under the lease executed with Tosei Engineering in November of 2019.

Interest income was \$67,129 for the year ended May 31, 2020 as compared to \$24,221 in 2019. Interest income was offset by interest expense of \$2,435 and \$12,160 for the Fiscal Years ended May 31, 2020 and 2019, respectively. Fluctuations in interest income are impacted by the levels of our average cash and investment balances and changes in interest rates.

The foreign currency exchange gain and loss fluctuates with the strength of foreign currencies against the U.S. dollar during the respective periods. Foreign currency exchange gain was \$3,700 for the year ended May 31, 2020 as compared to a loss of \$3,186 for Fiscal 2019.

Adjusted EBITDA – Adjusted EBITDA, which excludes certain reorganization, legal and other professional expense and inventory adjustments, was \$(573,502) for Fiscal 2020 as compared to Adjusted EBITDA of \$(226,078) in 2019.

Reconciliation of EBITDA to Adjusted EBITDA – Adjusted EBITDA for Fiscal 2020 and 2019 is calculated as follows:

	Fiscal year ended, May 31,	
	2020	2019
Loss before income taxes from continuing operations	\$ (1,856,942)	\$ (1,459,649)
Depreciation and amortization	161,137	173,216
EBITDA from continuing operations	<u>\$ (1,695,805)</u>	<u>\$ (1,286,433)</u>
Adjusted for:		
Stock-based compensation	354,048	94,621
Reorganization, legal, and transaction fees	842,162	752,481
Inventory adjustments	76,099	213,253
Software write-downs (Recoveries)	17,473	-
Income from discontinued product line	(167,479)	-
Adjusted EBITDA from continuing operations	<u>\$ (573,502)</u>	<u>\$ (226,078)</u>

Provision for income taxes – The effective tax rate in Fiscal 2020 was 1.2%, as compared (-2.2)% in Fiscal 2019. The effective tax rate on consolidated net income in Fiscal 2020 and 2019 differs from the federal statutory tax rate primarily due to changes in the deferred tax valuation allowance and the impact of certain expenses not being deductible for income tax reporting purposes.

Net income (loss) –For Fiscal 2020, net loss from continuing operations was \$(1,842,304), or \$(0.47), and income from discontinued operations and gain on sale, net of tax, of \$5,722,879, or \$1.45 per fully diluted share, for Fiscal 2020.

LIQUIDITY AND CAPITAL RESOURCES

The Company's working capital increased \$3,683,547 to \$10,953,464 as of May 31, 2020 compared to \$7,269,917 as of May 31, 2019. The increase in working capital in Fiscal 2020 was primarily impacted by the sale of SBS. Primarily as a result of the sale, cash, cash equivalents and restricted cash increased \$9,009,096 from \$1,467,435 as of May 31, 2019 to \$10,566,531 as of May 31, 2020.

Accounts payable increased \$165,094 from \$102,566 at May 31, 2019 to \$267,660 at May 31, 2020, which was primarily related to an increase at year end in professional and legal expenses incurred related to planning and execution of strategic business opportunities.

Inventories decreased \$181,775 to \$1,059,337 as of May 31, 2020 compared to \$1,241,132 as of May 31, 2019. The decrease was due, in part, to inventory adjustments of \$(76,099) and \$(213,253), in Fiscal Years 2020 and 2019, respectively. These inventory adjustments were the outcome of management's requirement to complete an in-depth review of the inventory, with standards of the review focused on more current turnover. Additional reduction in inventory is a reflection of the Company's efforts to streamline inventory purchases as they focus on increased turns and lean purchasing.

Other items that impacted working capital included the changes in accounts receivable, other accrued liabilities, and accrued taxes. At May 31, 2020, accounts receivable decreased \$56,200 to \$574,926 compared to \$631,126 as of May 31, 2019. The decrease in accounts receivable was primarily due to the impacts of Covid-19, which was a driver in the decrease in year over year sales. Other accrued liabilities increased \$459,139 to \$587,492 at May 31, 2020 compared to \$128,353 at May 31, 2019. The increase was driven an increase in professional and legal fees at year end related to strategic business planning opportunities, including the acquisition of Ample Hills Creamery. Accrued taxes at year end was \$265,349 as of Fiscal Year end May 31, 2020 as compared to \$0 as of Fiscal Year end 2019. The increase is related to a tax accrual booked to reserve for tax liabilities.

Cash used in operating activities, for continuing operations, was \$228,944 in Fiscal 2020 as compared to cash used by operating activities of \$1,379,175 in Fiscal 2019. The net loss, increase in other accrued liabilities, and accounts payable were the primary drivers of the overall operating cash usage for Fiscal 2020. The most significant component of the cash used in operating activities for Fiscal 2019 was the cash used for accounts payable.

Net cash provided by investing activities, for continuing operations was \$10,396,607 in Fiscal 2020 as compared to cash used of \$4,673 for Fiscal 2019. The Fiscal Year 2020 investing activity is related to the sale of the SBS business. See Note 10 to the financial statements below for further details.

Net cash used by financing activities was \$1,391,576 for the year ended May 31, 2020 was due to the repurchase of shares as part of the Dutch Tender offer and the repurchase of shares from a large company stockholder. See the notes to the financial statements for further details on the share repurchase.

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

QUARTERLY FINANCIAL DATA – Continuing Operations

In thousands, except per share information

	Fiscal quarter of 2019 ending,			
	8/31/2018	11/30/2018	2/28/2019	5/31/2019
Consolidated revenue	1,246	1,158	1,121	1,204
Gross profit	479	482	415	393
Net loss	(295)	(339)	(424)	(410)
Net loss per share, basic	\$ (0.07)	\$ (0.08)	\$ (0.11)	\$ (0.10)
Net loss per share, diluted	\$ (0.07)	\$ (0.08)	\$ (0.11)	\$ (0.10)

	Fiscal quarter of 2020 ending,			
	8/31/2019	11/31/2019	2/28/2020	5/31/2020
Consolidated revenue	1,095	1,033	1,095	967
Gross profit	477	390	604	480
Net loss	(222)	(676)	(240)	(704)
Net loss per share, basic	\$ (0.06)	\$ (0.17)	\$ (0.06)	\$ (0.18)
Net loss per share, diluted	\$ (0.06)	\$ (0.17)	\$ (0.06)	\$ (0.18)

Recent Accounting Pronouncements

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

Critical Accounting Policies

The analysis of our financial condition and results of operations, above, are based upon our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America.

In preparing the financial statements certain estimates and judgments are required that affect the reported amounts within the Income Statement and Balance Sheet. Note 2 — Summary of Significant Accounting Policies in the accompanying Notes to the Consolidated Financial Statements describes the significant accounting policies and methods used in the preparation of our Consolidated Financial Statements.

Management asserts the estimates, assumptions and judgments involved in the accounting policies described below have the greatest potential impact on our Consolidated Financial Statements and have deemed these to be our critical accounting policies and estimates.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

The Company did not have any derivative financial instruments as of May 31, 2020. However, the Company could be exposed to interest rate risk at any time in the future and, therefore, employs established policies and procedures to manage its exposure to changes in the market risk of its cash equivalents.

The Company's interest income and expense are most sensitive to changes in the general level of U.S. interest rates. In this regard, changes in the U.S. interest rates affect the interest earned on the Company's interest bearing cash equivalents and short term investments. The Company has no credit line or other long-term obligations whose interest rates are based on variable rates that may fluctuate over time based on economic changes in the environment. Therefore, at this time, the Company is not subject to interest rate risk on outstanding interest bearing obligations if market interest rates fluctuate and does not expect any change in the interest rates to have a material effect on the Company's results from operations.

Foreign Currency Risk

The Company markets and sells its products worldwide and acquire certain materials and services from vendors transacted in foreign currencies. Therefore, the Company's business and financial condition is sensitive to currency exchange rates or any other restrictions imposed on their currencies. Results of operations included foreign exchange gains/(losses) of \$3,700 and \$(3,186) for Fiscal 2020 and 2019, respectively.

Item 8. Financial Statements and Supplementary Data

SCHMITT INDUSTRIES, INC.
CONSOLIDATED BALANCE SHEETS

	Year Ended May 31,	
	2020	2019
ASSETS		
Current assets		
Cash and cash equivalents	\$ 10,146,531	\$ 1,467,435
Restricted cash	420,000	-
Accounts receivable, net	574,926	631,126
Inventories	1,059,357	1,241,132
Prepaid expenses	60,674	101,617
Current assets held for sale	-	5,192,384
Total current assets	<u>12,261,488</u>	<u>8,633,694</u>
Property and equipment, net	652,136	753,407
Other assets		
Intangible assets, net	287,602	392,185
Noncurrent assets held for sale	-	85,967
TOTAL ASSETS	<u>\$ 13,201,226</u>	<u>\$ 9,865,253</u>
LIABILITIES & STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 267,660	\$ 102,566
Accrued commissions	41,450	71,663
Accrued payroll liabilities	86,372	112,351
Accrued liabilities	265,349	-
Customer deposits and prepayments	12,239	78,376
Other accrued liabilities	587,492	128,353
Income taxes payable	47,462	491
Current portion of long-term liabilities	-	20,828
Current liabilities held for sale	-	849,149
Total current liabilities	<u>1,308,024</u>	<u>1,363,777</u>
Long-term liabilities	-	28,543
Total liabilities	<u>1,308,024</u>	<u>1,392,320</u>
Stockholders' equity		
Common stock, no par value, 20,000,000 shares authorized, 3,784,554 shares issued and outstanding at May 31, 2020 and 4,032,878 shares issued and outstanding at May 31, 2019	12,257,306	13,245,439
Accumulated other comprehensive loss	-	(527,827)
Accumulated deficit	(364,104)	(4,244,679)
Total stockholders' equity	<u>11,893,202</u>	<u>8,472,933</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 13,201,226</u>	<u>\$ 9,865,253</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENT

SCHMITT INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

	Year Ended May 31,	
	2020	2019
Net Sales	\$ 4,189,924	\$ 4,729,442
Cost of revenue	2,239,376	2,960,680
Gross profit	<u>1,950,548</u>	<u>1,768,762</u>
Operating expenses:		
General, administration and sales	4,061,621	3,180,497
Research and development	68,849	56,833
Total operating expenses	<u>4,130,470</u>	<u>3,237,330</u>
Operating (loss)	(2,179,922)	(1,468,568)
Other income (expense), net	322,980	8,919
Loss before income taxes	(1,856,942)	(1,459,649)
Income tax provision (benefit) from continuing operations	(14,638)	8,783
Net loss from continuing operations	(1,842,304)	(1,468,432)
Income from discontinued operations, including gain on sale, net of tax	5,722,879	257,442
Net income (loss)	<u>\$ 3,880,575</u>	<u>\$ (1,210,990)</u>
Net loss per common share from continuing operations:		
Basic	\$ (0.47)	\$ (0.37)
Weighted average number of common shares, basic	<u>3,939,833</u>	<u>4,005,795</u>
Diluted	\$ (0.47)	\$ (0.37)
Weighted average number of common shares, diluted	<u>3,939,833</u>	<u>4,005,795</u>
Net income per common share from discontinued operations:		
Basic	\$ 1.45	\$ 0.06
Weighted average number of common shares, basic	<u>3,939,833</u>	<u>4,005,795</u>
Diluted	\$ 1.45	\$ 0.06
Weighted average number of common shares, diluted	<u>3,939,833</u>	<u>4,005,795</u>
Net income (loss) per common share:		
Basic	\$ 0.98	\$ (0.30)
Weighted average number of common shares, basic	<u>3,939,833</u>	<u>4,005,795</u>
Diluted	\$ 0.98	\$ (0.30)
Weighted average number of common shares, diluted	<u>3,939,833</u>	<u>4,005,795</u>
Comprehensive income (loss)		
Net income (loss)	\$ 3,880,575	\$ (1,210,990)
Foreign currency translation adjustment	-	8,480
Total comprehensive income (loss)	<u>\$ 3,880,575</u>	<u>\$ (1,202,510)</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS

SCHMITT INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year-ended, May 31,	
	2020	2019
Cash flows relating to operating activities		
Net income (loss)	\$ 3,880,575	\$ (1,210,990)
Pre-tax earnings from discontinued operations	(616,711)	(275,107)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	161,137	173,216
Loss on disposal of property and equipment	74,020	-
Stock based compensation	354,048	94,621
Reserve for excess or obsolete inventories	-	116,131
Gain on sale of discontinued operations before income taxes	(5,166,845)	-
(Increase) decrease in:		
Accounts receivable	56,200	(145,238)
Inventories	181,775	(14,156)
Prepaid expenses	40,943	(21,244)
Increase (decrease) in:		
Accounts payable	165,094	(109,714)
Accrued liabilities and customer deposits	328,450	17,405
Accrued taxes	265,349	-
Income taxes payable	46,971	(4,098)
Net cash provided by (used in) operating activities - continuing operations	(228,994)	(1,379,175)
Net cash provided by operating activities - discontinued operations	257,735	681,522
Net cash provided by (used in) operating activities - total	\$ 28,741	\$ (697,653)
Cash flows relating to investing activities		
Purchases of property and equipment	\$ (32,982)	\$ (4,673)
Proceeds from the sale of property and equipment	3,000	-
Proceeds from sale of net assets of discontinued operations	10,426,589	-
Net cash provided by (used in) investing activities - continuing operations	10,396,607	(4,673)
Net cash provided by (used in) investing activities - discontinued operations	(6,649)	-
Net cash provided by (used in) investing activities - total	\$ 10,389,958	\$ (4,673)
Cash flows relating to financing activities		
Payments on current and long-term liabilities	\$ (49,395)	\$ (15,424)
Common stock issued on exercise of stock options	8,500	65,166
Repurchase of equity	(1,350,681)	-
Net cash provided by (used in) financing activities	(1,391,576)	49,742
Effect of foreign exchange translation on cash	71,973	8,485
Increase (decrease) in cash, cash equivalents and restricted cash	9,099,096	(644,098)
Cash, cash equivalents and restricted cash, beginning of period	1,467,435	2,111,533
Cash, cash equivalents and restricted cash, end of period	10,566,531	1,467,435
Supplemental disclosure of cash flow information		
Cash paid during the period for income taxes	\$ 4,289	\$ 29,940
Cash paid during the period for interest	\$ 2,435	\$ 12,160
Supplemental disclosure of non-cash investing and financing activities		
Acquisition of property and equipment through financed payables	\$ -	\$ 145,784

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS

SCHMITT INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Shares	Amount	Accumulated other comprehensive income (loss)	Accumulated deficit	Total
Balance, May 31, 2018	3,994,545	\$ 13,085,652	(536,307)	(3,033,689)	\$ 9,515,656
Exercise of stock options	38,333	65,166	-	-	65,166
Stock-based compensation	-	94,621	-	-	94,621
Net loss	-	-	-	(1,210,990)	(1,210,990)
Other comprehensive income	-	-	8,480	-	8,480
Balance, May 31, 2019	<u>4,032,878</u>	<u>\$ 13,245,439</u>	<u>\$ (527,827)</u>	<u>\$ (4,244,679)</u>	<u>\$ 8,472,933</u>
Stock compensation expense for restricted stock units granted to employees and directors	-	354,048	-	-	354,048
Repurchase of common stock	(418,051)	(1,350,681)	-	-	(1,350,681)
Exercise of stock options	33,166	8,500	-	-	8,500
Restricted stock units exercised	136,561	-	-	-	-
Net income	-	-	-	3,880,575	3,880,575
Other comprehensive income	-	-	527,827	-	527,827
Balance, May 31, 2020	<u>3,784,554</u>	<u>\$ 12,257,306</u>	<u>\$ -</u>	<u>\$ (364,104)</u>	<u>\$ 11,893,202</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS

Schmitt Industries, Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED MAY 31, 2020 AND 2019

NOTE 1 – THE COMPANY

Schmitt Industries is a world leader in providing highly precise test and measurement products and services that help customers save money, increase production efficiency and improve product quality. After the sale of the SBS business, based on the types of products and services sold, and an analysis of how the Company reviews and manages operations, the Company determined that it operates as one segment. Through its wholly owned subsidiary, Schmitt Measurement Systems, Inc., the Measurement segment manufactures and sells products in two core product lines, Acuity Lasers and Xact Tank Monitoring.

- Acuity™ was acquired in June of 2000 and manufactures and markets dimensional and distance measurement lasers. These laser products utilize both triangulation and time-of-flight measurement principles and are known for their speed and accuracy. The Acuity products are used in a wide variety of industrial, commercial and research applications.
- Xact™ was acquired in 2007 and offers ultrasonic measurement technology for the remote monitoring of the fill levels of propane and other liquid tanks. Together with the Xact gauge reader, the satellite-focused Xact systems can detect and communicate fill levels, along with other information such as tank size and configuration, to customers through the “Internet of Things” ecosystem using our satellite provider and a secure website. Typical users of Xact systems are bulk propane, diesel, jet fuel suppliers and ammonia users and distributors.

Additionally, as discussed further in Note 11, the Company now operates Ample Hills Creamery following the July 9, 2020 successful asset purchase of, among other things, Ample Hills’ equipment, inventory, and all intellectual property, including the names and marks of “AMPLE HILLS” and “AMPLE HILLS CREAMERY” and all derivatives thereof.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

These Consolidated Financial Statements include those of the Company and its wholly owned subsidiaries: Schmitt Measurement Systems, Inc. and Schmitt Industries (Canada) Limited. All significant intercompany accounts and transactions have been eliminated in the preparation of the Consolidated Financial Statements.

Reclassification

Certain amounts in the prior period consolidated balance sheet have been reclassified to conform to the presentation of the current period. These reclassifications had no effect on previously recorded net income.

Revenue Recognition

The Company determines the amount of revenue it recognizes associated with the transfer of each product or service. For sale of products or delivery of monitoring services to all customers, each transaction is evaluated to determine whether there is approval and commitment from both the Company and the customer for the transaction; whether the rights of each party are specifically identified; whether the transaction has commercial substance; whether collectability from the customer is probable at the inception of the contract and whether the transaction amount is defined. If a transaction to sell products or provide monitoring services meets all of the above criteria, revenue is recognized for the sales of product at the time of shipment or for monitoring services at the completion of the month in which monitoring services are provided.

The Company incurs commissions associated with the sales of products, which are accrued and expensed at the time the product is shipped. These amounts are recorded within general, administration and sales expense. The Company also incurs costs related to shipping and handling of its products, the costs of which are expensed as incurred as a component of cost of sales. Shipping and handling fees billed to customers, which are recognized at the time of shipment as a component of net revenues, were \$29,707 and \$33,929 for the year ended May 31, 2020 and May 31, 2019, respectively.

Cash, Cash Equivalents and Restricted Cash

The Company generally invests its excess cash in money market funds. The Company's investment policy also allows for cash to be invested in investment grade highly liquid securities, and the Company considers securities that are highly liquid, readily convertible into cash and have original maturities of less than three months when purchased to be cash equivalents. The Company's cash consists of demand deposits in large financial institutions and money market funds. At times, balances may exceed federally insured limits. Restricted cash consists of an amount held in escrow related to the sale of the balancer business segment, as described in notes to the financial statements. Once certain events are complete, the restrictions on this cash payment will be released.

The following table provides a reconciliation of cash and cash equivalents and restricted cash as reported within the Consolidated Balance Sheets as of May 31, 2020 and 2019 to the sum of the same such amounts as shown in the Consolidated Statement of Cash Flows for the respective years then ended:

	Years ended May 31,	
	2020	2019
Cash and cash equivalents	\$ 10,146,531	\$ 1,467,435
Restricted cash	420,000	-
Total cash, cash equivalents and restricted cash shown in the Consolidated Statement of Cash Flows	<u>\$ 10,566,531</u>	<u>\$ 1,467,435</u>

Accounts Receivable

The Company maintains credit limits for all customers based upon several factors, including but not limited to financial condition and stability, payment history, published credit reports and use of credit references. Management performs various analyses to evaluate accounts receivable balances to ensure recorded amounts reflect estimated net realizable value. This review includes using accounts receivable aging reports, other operating trends and relevant business conditions, including general economic factors, as they relate to each of the Company's domestic and international customers. In the event there is doubt about whether a customer account is collectible, a reserve is provided. If these analyses lead management to the conclusion that a customer account is uncollectible, the balance will be directly charged to bad debt expense. The allowance for doubtful accounts was \$103,029 and \$36,826 as of May 31, 2020 and 2019, respectively.

Inventories

Inventories are valued at the lower of cost or net realizable value with cost determined on the average cost basis. Costs included in inventories consist of materials, labor and manufacturing overhead, which are related to the purchase or production of inventories. Write-downs, when required, are made to reduce excess inventories to their net realizable values. Such estimates are based on assumptions regarding future demand and market conditions. If actual conditions become less favorable than the assumptions used, an additional inventory write-down may be required.

Inventory balances as of May 31, 2020 and 2019, respectively, consisted of:

	Fiscal Year ended, May 31,	
	2020	2019
Raw materials	\$ 154,293	\$ 347,095
Work-in-process	525,615	376,375
Finished goods	379,449	517,662
Total Inventory	<u>\$ 1,059,357</u>	<u>\$ 1,241,132</u>

Property and Equipment

Property and equipment are stated at cost, less depreciation and amortization. Depreciation is computed using the straight-line method over estimated useful lives of three to seven years for furniture, fixtures, and equipment; three years for vehicles; and twenty-five years for buildings and improvements. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation expense for the year ended May 31, 2020 and 2019 was \$56,554 and \$68,633, respectively.

Net property, plant and equipment balances as of May 31, 2020 and 2019, respectively, consisted of:

	Fiscal Year ended, May 31,	
	2020	2019
Land	\$ 299,000	\$ 299,000
Buildings and improvements	1,847,505	1,814,524
Furniture, fixtures and equipment	396,264	498,476
	<u>2,542,769</u>	<u>2,612,000</u>
Less accumulated depreciation	(1,890,633)	(1,858,593)
	<u>\$ 652,136</u>	<u>\$ 753,407</u>

Lease Accounting

The Company determines if an arrangement is a lease or a service contract at inception. Where an arrangement is a lease the Company determines if it is an operating lease or a finance lease. Subsequently, if the arrangement is modified the Company reevaluates the classification. Buildings leased to others under operating leases are included in property, plant and equipment.

On November 22, 2019, the Company entered in a commercial lease agreement, which has been accounted for pursuant to (ASU) No. 2016-02, "Leases (Topic 842)". The Company elected the practical expedient to not separate lease and non-lease components and will present property revenues as other income, combined based upon the lease being determined to be the predominant component.

The lessor commercial agreement contains a 10-year term with a renewal option to extend, which will be considered a new, separate contract and will be recognized at the time the option is exercised on a straight-line basis over the renewal period, and early termination options based on established terms specific to the individual agreement. Minimum future lease payments receivable are as follows:

	Years ending May 31,
2021	\$ 283,578
2022	291,906
2023	300,666
2024	309,870
2025	319,164
Thereafter	1,557,600
Total undiscounted cash flow	<u>\$ 3,062,784</u>

Intangible Assets and Impairment

Amortizable intangible assets, which include purchased technology and patents, are amortized over their estimated useful lives ranging from five to seventeen years. As of May 31, 2020 and May 31, 2019, amortizable intangible assets were \$2,085,362 and \$2,200,883, and accumulated amortization was \$1,797,760 and \$1,808,698, respectively. Amortization expense for the year ended May 31, 2020 and May 31, 2019 was \$104,583. Amortization expense for each of the following years ending May 31 is expected to be as follows;

	Years ending May 31,
2021	\$ 104,583
2022	104,583
2023	78,436
2024	-
2025	-
Thereafter	-
	<u>\$ 287,602</u>

Intangible and other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. Recoverability is determined by comparing the forecasted future 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, 2020, no impairment existed.

Customer deposits and prepayments

Customer deposits and prepayments consists of amounts received from customers as prepayments for orders that have been received and have been produced but have not yet shipped, credit balances for items returned by customers for which refunds have not yet been provided and deposits made by customers in advance of production.

Other accrued liabilities

As of May 31, 2020, other accrued liabilities included \$237,633 of accrued professional and legal expenses related to transaction and turn-around costs, \$121,959 in costs related to Xact Monitoring services provided to clients for Fiscal Year 2020, and \$82,811 of customer deposits due to SBS Accretech. It also included an accrual for warranty reserve and sales return reserve, recurring professional expenses for consulting relationships, legal fees related to business planning expenses, amounts financed on a short-term arrangement for the purchase of the Company's new enterprise resource planning software and amounts owing under various professional fee contracts for which invoices have not yet been received.

Foreign Currency

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." Transaction gains and losses are included in net income (loss).

Advertising

Advertising costs included in general, administration and sales, are expensed when the advertising first takes place. Advertising expense was \$7,767 and \$22,018 for the years ended May 31, 2020 and 2019, respectively.

Research and Development Costs

Research and development costs, predominately internal labor costs and costs of materials, are charged to expense when incurred.

Warranty Reserve

Warranty costs are estimated and charged to operations to cover a defined warranty period. The estimated warranty cost is based on the history of warranty claims for each particular product type. For new product types without a warranty history, preliminary estimates are based on historical information for similar product types. The warranty reserve accruals, included in other accrued liabilities, are reviewed periodically and updated based on warranty trends.

Stock-Based Compensation

Stock-based compensation includes expense charges for all stock-based awards to employees and directors granted under the Company's stock option plan. The Company requires the measurement and recognition of compensation for all stock-based awards made to employees and directors including stock options based on estimated fair values.

Stock-based compensation recognized during the period is based on the value of the portion of the stock-based award that will vest during the period, adjusted for expected forfeitures. Compensation cost for all stock-based awards is recognized using the straight-line method.

Income Taxes

Each year the Company files income tax returns in the various taxing jurisdictions in which it operates. These tax returns are subject to examination and possible challenge by the taxing authorities. Positions challenged by the taxing authorities may be settled or appealed by the Company. As a result, there is an uncertainty in income taxes recognized in the Company's financial statements in accordance with ASC Topic 740. The Company applies this guidance by defining criteria that an individual income tax position must meet for any part of the benefit of that position to be recognized in an enterprise's financial statements and provides guidance on measurement, de-recognition, classification, accounting for interest and penalties, accounting in interim periods, disclosure, and transition.

The Company applies the asset and liability method in recording income taxes, under which deferred income tax assets and liabilities are determined, based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using currently enacted tax rates and laws. Additionally, deferred tax assets are evaluated and a valuation allowance is established if it is more likely than not that all or a portion of the deferred tax asset will not be realized. Management continues to review the level of the valuation allowance on a quarterly basis.

Accrued Liabilities

In Q4 of Fiscal 2020, the Company determined that it was more likely than not that the Company had a pre-existing tax liability related to prior periods. The Company has analyzed the liability and estimated it to be \$265,349 as of May 31, 2020. Accordingly, the Company recognized \$265,349 in operating expenses in Q4 of Fiscal 2020 to accrue for the liability.

Earnings (Loss) Per Share

Basic earnings (loss) per share is computed using the weighted average number of common shares outstanding. Diluted earnings (loss) per share is computed using the weighted average number of common shares outstanding, adjusted for dilutive incremental shares attributed to outstanding options to purchase common stock. Common stock equivalents for stock options are computed using the treasury stock method. In periods in which a net loss is incurred, no common stock equivalents are included since they are antidilutive and as such all stock options outstanding are excluded from the computation of diluted net loss in those periods. There were 8,888 and 43,751 potentially dilutive common shares from outstanding stock options have been excluded from diluted earnings (loss) per share for the years ended May 31, 2020 and 2019, respectively.

Concentration of Credit Risk

Financial instruments that potentially expose the Company to concentration of credit risk are trade accounts receivable. Credit terms generally require an invoice to be paid within 30 to 60 days or include a discount of up to 1.5% if the invoice is paid within ten days, with the net amount payable in 30 days. Terms are set for each account depending on the customer's credit standing with the Company.

Financial Instruments

The carrying value of all other financial instruments potentially subject to valuation risk (principally consisting of cash and cash equivalents, accounts receivable, accounts payable and the current portion of long-term liability) approximates fair value because of their short-term maturities.

Shipping and Handling

The Company incurs costs related to shipping and handling of its manufactured products. These costs are expensed as incurred as a component of cost of sales. Shipping and handling charges related to the receipt of raw materials are also incurred, which are recorded as a cost of the related inventory.

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.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) issued a new accounting standard on leasing. The new standard requires companies to record most leased assets and liabilities on the balance sheet, and also proposed a dual model for recognizing expense. The Company adopted the standard as of June 1, 2019, with retroactive reporting for prior periods (the comparative option). Adoption of these accounting changes did not have a material impact on the Consolidated Financial Statements.

In January 2017, the FASB issued a new accounting standard which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. This guidance was effective for the Company beginning in 2019. Adoption of these accounting changes did not have a material impact on the Consolidated Financial Statements.

In May 2017, the FASB issued a new accounting standard which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in ASC Topic 718. Under the guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. This guidance was effective for the Company beginning in 2019. Adoption of these accounting changes did not have a material impact on the Consolidated Financial Statements.

In June 2018, the FASB issued a new accounting standard which provides guidance that expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. This guidance was effective for the Company beginning in 2019, with early adoption permitted. Adoption of these accounting changes did not have a material impact on the Consolidated Financial Statements.

NOTE 3 - INCOME TAXES

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”). The Tax Act made broad and complex changes to the U.S. tax code by reducing the U.S. federal corporate tax rate from 34 percent to 21 percent, requiring companies to pay a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries, generally eliminating U.S. federal income taxes on dividends from foreign subsidiaries, creating a new limitation on deductible interest expense and changing rules related to uses and limitations of net operating loss carryforwards created in tax years beginning after December 31, 2017.

The SEC staff subsequently issued Staff Accounting Bulletin 118 (“SAB 118”), which provides a one-year measurement for companies to complete the accounting for the effects of the Tax Act. In accordance with SAB 118, where accounting is complete, a company must reflect the income tax effects of those aspects, but to the extent that a company’s accounting is incomplete but a reasonable estimate may be made, a provisional estimate should be recorded in the financial statements. Where a company is unable to determine a provisional estimate, SAB 118 permits application of the tax laws that were in effect immediately before the enactment.

Effective Tax Rate

The effective tax rate for the three months ended May 31, 2020 was 1.2%. The effective tax rate on consolidated net income for the year ended May 31, 2020 and 2019 differs from the federal statutory tax rate primarily due to changes in the deferred tax valuation allowance and the impact of certain expenses not being deductible for income tax reporting purposes. Management believes the effective tax rate for Fiscal 2020 will be approximately 1.2% due to the items noted above.

The provision for income taxes is as follows:

	Year ended May 31,	
	2020	2019
Current provision for continued operations	(14,638)	8,783
Current provision for discontinued operations	60,677	17,655
Deferred provision	999,420	329,035
Change in valuation allowance	(999,420)	(329,035)
Total provision for income taxes	<u>\$ 46,039</u>	<u>\$ 26,438</u>

Deferred tax assets are comprised of the following components:

	2020	2019
Basis difference for assets	\$ 162,853	\$ 182,654
Inventory related items	75,500	169,585
Other reserves and liabilities	112,829	74,694
Net operating loss carryforward	624,650	1,507,141
General business and other credit carry forward	455,841	489,327
Other deferred items, net	-	7,692
Gross deferred tax assets	1,431,673	2,431,093
Deferred tax asset valuation allowance	(1,431,673)	(2,431,093)
Net deferred tax assets	<u>\$ -</u>	<u>\$ -</u>

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. The Company has recorded a substantial deferred tax asset related to temporary differences between book and tax basis of assets and liabilities and net operating loss carryforwards. During the year ended May 31, 2020, the Company decreased its valuation allowance by \$999,420 which was due to the use of net operating losses carryforwards used against the gain on the sale. The year ended May 31, 2019, the Company increased its valuation allowance \$329,035 as a result of the increase in the Company's deferred tax assets most of which was due to the increase in net operating losses carryforwards generated by the Fiscal 2019 results. The Company has provided a full valuation allowance against all of its deferred tax assets as the recent losses from continuing operations have been given more weight than projected future income when determining the need for a valuation allowance.

The Company has federal net operating loss carryforwards of approximately \$2,230,773 which begin to expire in 2037 along with the federal general business and other credit carryforwards. The Company has state net operating loss carryforwards of approximately \$2,690,375 million which begin to expire in 2031.

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 due to the following:

	2020	2019
Statutory Federal Rate	21.0%	21.0%
State Taxes, net of federal benefit	5.3%	5.3%
Change in deferred tax valuation allowance	-27.1%	-25.7%
Impact of Tax Act	0%	0.0%
Stock-based compensation	0%	-1.8%
R&E tax credits	0.2%	1.8%
Effect of foreign income tax rates	-0.1%	-3.4%
Deferred tax true-up	0.0%	4.1%
State minimum taxes	1.7%	-1.0%
Permanent and other differences	0.2%	-2.5%
Effective Tax Rate	<u>1.2%</u>	<u>-2.2%</u>

Interest and penalties associated with uncertain tax positions are recognized as components of the Provision for income taxes. The liability for payment of interest and penalties was \$0 as of May 31, 2020 and 2019. Several tax years are subject to examination by major tax jurisdictions. In the United States, federal tax years for the years ended May 31, 2017 and after are subject to examination. In the United Kingdom, tax year for the year ended May 31, 2019 is subject to examination.

NOTE 4 - 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 is funded at 5% of net revenues (defined as gross sales less returns, allowances and sales commissions) of the Company’s surface measurement 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, 2020 and 2019 amounted to \$29,965 and \$1,126, respectively.

NOTE 5 - STOCKHOLDER RIGHTS AGREEMENT

On July 1, 2019, the Company entered into a Section 382 Rights Agreement with Broadridge Corporate Issuer Solutions, Inc., as Rights Agent (the “Rights Agreement”) in an effort to protect stockholder value by attempting to diminish the risk that the Company’s ability to use its net operating losses (“NOLs”) to reduce U.S. taxable income and tax liabilities in future taxable periods may become substantially limited.

The Rights Agreement is intended to act as a deterrent to any person acquiring beneficial ownership of 4.9% or more of the Company’s outstanding common stock, no par value (“Common Stock”) without the approval of the Company’s Board of Directors (the “Board”). Stockholders who beneficially own 4.9% or more of the outstanding Common Stock as of the close of business on July 1, 2019 will not trigger the Rights Agreement so long as they do not acquire beneficial ownership of additional shares of Common Stock representing 0.5% or more of the outstanding Common Stock (other than pursuant to a dividend or distribution paid or made by the Company on the outstanding shares of Common Stock or pursuant to a split or subdivision of the outstanding shares of Common Stock) at a time when they still beneficially own 4.9% or more of the outstanding Common Stock. In addition, the Board retains the sole discretion to exempt any person or group from the penalties imposed by the Rights Agreement.

The Board remains open to all alternatives to maximize stockholder value, and may in its sole discretion, exempt a proposed acquisition of Common Stock from the Rights Agreement, including if it determines that the acquisition is in the Company’s best interests, or if it will not jeopardize the Tax Benefits. The Rights Agreement is not expected to interfere with any merger or other business combination approved by the Board.

The Board authorized the issuance of one right (a “Right”) for each outstanding share of Common Stock payable to stockholders of record as of the close of business on July 19, 2019 (the “Record Date”). One Right will also be issued together with each share of the Company’s Common Stock issued after the Record Date but before the Distribution Date (as defined below) and, in certain circumstances, after the Distribution Date. Subject to the terms, provisions and conditions of the Rights Agreement, if the Rights become exercisable, each Right would initially represent the right to purchase from the Company one one-thousandth of a share of Series A Junior Participating Preferred Stock, no par value, of the Company (the “Series A Preferred Stock”) for a purchase price of \$11.25 (the “Purchase Price”). If issued, each one-thousandth of a share of Series A Preferred Stock would give the stockholder approximately the same dividend, voting and liquidation rights as does one share of Common Stock. However, prior to exercise, a Right does not give its holder any rights as a stockholder of the Company, including, without limitation, any dividend, voting or liquidation rights.

The Rights will not be exercisable until the earlier of (i) ten business days after a public announcement that a person has become an “Acquiring Person” by acquiring beneficial ownership of 4.9% or more of outstanding Common Stock (or, in the case of a person that had beneficial ownership of 4.9% or more of the outstanding Common Stock as of the close of business on July 1, 2019, by obtaining beneficial ownership of any additional shares of Common Stock representing 0.5% or more of the shares of Common Stock then outstanding (other than pursuant to a dividend or distribution paid or made by the Company on the outstanding shares of the Common Stock or pursuant to a split or subdivision of the outstanding shares of Common Stock) at a time such person still beneficially owns 4.9% or more of the outstanding Common Stock), and (ii) ten business days (or such later date as may be specified by the Board prior to such time as any person becomes an Acquiring Person) after the commencement of a tender or exchange offer by or on behalf of a person that, if completed, would result in such person becoming an Acquiring Person (the “Distribution Date”).

Until the Distribution Date, Common Stock certificates or the ownership statements issued with respect to uncertificated shares of Common Stock will evidence the Rights. Any transfer of shares of Common Stock prior to the Distribution Date will also constitute a transfer of the associated Rights. After the Distribution Date, separate rights certificates will be issued and the Rights may be transferred other than in connection with the transfer of the underlying shares of Common Stock unless and until the Board has determined to effect an exchange pursuant to the Rights Agreement (as described below).

In the event that a person becomes an Acquiring Person, each holder of a Right, other than Rights that are or, under certain circumstances, were beneficially owned by the Acquiring Person (which will thereupon become void), will thereafter have the right to receive upon exercise of a Right and payment of the Purchase Price, a number of shares of the Company's Common Stock (or, in certain circumstances, cash, property or other securities of the Company) having a market value equal to two times the Purchase Price. However, Rights are subject to redemption and exchange at the option of the Company.

In the event that, at any time following a person becoming an Acquiring Person, (i) the Company engages in a merger or other business combination transaction in which the Company is not the surviving corporation; (ii) the Company engages in a merger or other business combination transaction in which the Company is the surviving corporation and the Common Stock is changed or exchanged; or (iii) 70% or more of the Company's assets, cash flow or earning power is sold or transferred, each holder of a Right (except Rights which have previously been voided as set forth below) shall thereafter have the right to receive, upon exercise of the Right, common stock of the acquiring company having a value equal to two times the Purchase Price.

At any time until the earlier of July 1, 2022, and ten calendar days following the first date of public announcement that a person has become an Acquiring Person or that discloses information which reveals the existence of an Acquiring Person or such earlier date as a majority of the Board becomes aware of the existence of an Acquiring Person, the Board may redeem the Rights in whole, but not in part, at a price of \$0.001 per Right (the "Redemption Price"). The redemption of the Rights may be made effective at such time, on such basis and with such conditions as the Board in its sole discretion may establish. Immediately upon any redemption of the Rights, the right to exercise the Rights will terminate and the only right of the holders of Rights will be to receive the Redemption Price.

At any time after a person becomes an Acquiring Person, the Board may, at its option, exchange the Rights (other than Rights that have become void), in whole or in part, at an exchange ratio of one share of Common Stock, or a fractional share of Series A Preferred Stock (or of a share of a similar class or series of the Company's preferred stock having similar rights, preferences and privileges) of equivalent value, per Right (subject to adjustment). Immediately upon an exchange of any Rights, the right to exercise such Rights will terminate and the only right of the holders of Rights will be to receive the number of shares of Common Stock (or fractional share of Series A Preferred Stock or of a share of a similar class or series of the Company's preferred stock having similar rights, preferences and privileges) equal to the number of such Rights held by such holder multiplied by the exchange ratio.

Each one one-thousandth of a share of Series A Preferred Stock, if issued: (i) will be junior to any other series of preferred stock the Company may issue (unless otherwise provided in the terms of such other series), (ii) will entitle holders to preferential cumulative quarterly dividends in an amount per share of Series A Preferred Stock equal to the greater of (a) \$1 or (b) 1,000 times the aggregate the dividends, if any, declared on one share of the Company's Common Stock, (iii) will entitle holders upon liquidation (voluntary or otherwise) to receive \$1,000 per share of Series A Preferred Stock plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, (iv) will have the same voting power as one share of Common Stock, and (v) will entitle holders to a per share payment equal to the payment made on one share of the Company's Common Stock, if shares of the Common Stock are exchanged via merger, consolidation, or a similar transaction. Because of the nature of the Series A Preferred Stock's dividend, liquidation and voting rights, the value of one one-thousandth of a share of Series A Preferred Stock purchasable upon exercise of each Right should approximate the value of one share of Common Stock.

The Rights and the Rights Agreement will expire on the earliest of (i) July 1, 2022, (ii) the time at which the Rights are redeemed pursuant to the Rights Agreement, (iii) the time at which the Rights are exchanged in full pursuant to the Rights Agreement, (iv) the date that the Board determines that the Rights Agreement is no longer necessary for the preservation of material valuable Tax Benefits, (v) the beginning of a taxable year of the Company to which the Board determines that no tax benefits may be carried forward, and (vi) a determination by the Board, prior to the time any Person becomes an Acquiring Person, that the Rights Agreement and the Rights are no longer in the best interests of the Company and its stockholders.

The Board may adjust the Purchase Price, the number of shares of Series A Preferred Stock or other securities or assets issuable and the number of outstanding Rights to prevent dilution that may occur as a result of certain events, including among others, a stock dividend, a stock split or a reclassification of the Series A Preferred Stock or Common Stock. With certain exceptions, no adjustments to the Purchase Price will be required until cumulative adjustments amount to at least 1% of the Purchase Price.

For so long as the Rights are redeemable, the Board may supplement or amend any provision of the Rights Agreement in any respect without the approval of the holders of the Rights. From and after the time the Rights are no longer redeemable, the Board may supplement or amend the Rights Agreement only to cure an ambiguity, to alter time period provisions, to correct inconsistent provisions, or to make any additional changes to the Rights Agreement which the Company may deem necessary or desirable, but only to the extent that those changes do not impair or adversely affect any Rights holder (other than an Acquiring Person or any Affiliate or Associate of an Acquiring Person or certain of their transferees) and do not result in the Rights again becoming redeemable or the Rights Agreement again becoming amendable other than in accordance with this sentence.

NOTE 6 - STOCK BASED COMPENSATION

Stock-based compensation includes expense charges for all stock-based awards to employees and directors granted under the Company's stock option plan. Stock-based compensation recognized during the period is based on the portion of the grant date fair value of the stock-based award that will vest during the period, adjusted for expected forfeitures. Compensation cost for all stock-based awards is recognized using the straight-line method.

Stock Options

The Company uses the Black-Scholes option pricing model as its method of valuation for stock-based awards. The Black-Scholes option pricing model requires the input of highly subjective assumptions, and other reasonable assumptions could provide differing results. These variables include, but are not limited to:

- *Risk-Free Interest Rate.* The Company bases the risk-free interest rate on the implied yield currently available on U.S. Treasury issues with an equivalent remaining term approximately equal to the expected life of the award.
- *Expected Life.* The expected life of awards granted represents the period of time that they are expected to be outstanding. The Company determines the expected life based on historical experience with similar awards, giving consideration to the contractual terms, vesting schedules and pre-vesting and post-vesting forfeitures.
- *Expected Volatility.* The Company estimates the volatility of its common stock at the date of grant based on the historical volatility of its common stock. The volatility factor the Company uses is based on its historical stock prices over the most recent period commensurate with the estimated expected life of the award. These historical periods may exclude portions of time when unusual transactions occurred.
- *Expected Dividend Yield.* The Company does not anticipate paying any cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield of 0.
- *Expected Forfeitures.* The Company uses relevant historical data to estimate pre-vesting option forfeitures. The Company records stock-based compensation only for those awards that are expected to vest.

The Company has computed, to determine stock-based compensation expense recognized for the years ended May 31, 2020 and 2019, the value of all stock options granted using the Black-Scholes option pricing model using the following assumptions:

	Year Ended May 31,	
	2020	2019
Average risk-free interest rate	N/A	3.1%
Expected life	N/A	6.0 years
Expected volatility	N/A	46.3%

There were no options granted during the year ended May 31, 2020 and the Company had outstanding stock options to purchase 22,500 shares of Common Stock as of May 31, 2020. All outstanding options are fully vested and exercisable with a weighted average exercise price of \$1.70. As all options outstanding as of May 31, 2020 were fully vested, the Company did not record any additional stock-based compensation expense during the year ending May 31, 2020.

Outstanding Options		Exercisable Options	
Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (yrs)	Weighted Average Exercise Price
22,500	\$ 1.70	6.9	\$ 1.70

Options granted, exercised, canceled and expired under the Company's stock-based compensation plans during the years ended May 31, 2020 and 2019 are summarized as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Options outstanding and exercisable - May 31, 2018	318,332	\$ 2.36	6.8	\$ 751,264
Options granted	15,000	2.45		
Options exercised	(38,333)	1.70		
Options forfeited/canceled	(40,833)	2.66		
Options outstanding and exercisable - May 31, 2019	254,166	\$ 2.41	5.8	\$ 612,540
Options granted	-			
Options exercised	(69,166)	1.82		
Options forfeited/canceled	(162,500)	2.77		
Options outstanding and exercisable - May 31, 2020	22,500	\$ 1.70	6.9	\$ 38,250

Restricted Stock Units

Service-based and market-based restricted stock units are granted to key employees and members of the Company's Board of Directors. Service-based restricted stock units are valued at the stock price at date of grant and amortized on a straight-line over the vesting period. Service-based restricted stock units generally fully vest on the first anniversary date of the award. Market-based restricted stock units are contingent on continued service and vest based on the 15-day average closing price of the Company's Common Stock equal or exceeding certain targets established by the Compensation Committee of the Board of Directors.

The lattice model utilizes multiple input variables that determine the probability of satisfying the market conditions stipulated in the award and calculates the fair value of the market-based restricted stock units. The Company used the following assumptions in determining the fair value of market based restricted stock units:

	Year Ended May 31,	
	2020	2019
Expected stock price volatility	54.1%	50.1% - 57.5%
Expected dividend yield	0%	0%
Average risk-free interest rate	2.3%	2.55% - 2.98%

The expected stock price volatility for each grant is based on the historical volatility of the Company's stock for a period equivalent to the derived service period of each grant. The expected dividend yield is based on annual expected dividend payments. The average risk-free interest rate is based on the treasury yield rates as of the date of grant for a period equivalent to the derived service period of each grant. The fair value of each restricted stock unit is amortized over the requisite or derived service period, which is up to five years. The restricted stock units granted during the year ended May 31, 2020 have a grant date fair value of \$218,379.

For the year ended May 31, 2020, six tranches, consisting of 18,000 units, of market-based restricted stock units were granted. The fair value of the on the grant date of the units was \$27,900. The following table summarizes the vesting terms for the market-based restricted stock units granted in Fiscal 2020:

Number of restricted stock units	Target Price
3,000	\$ 4.00
3,000	\$ 4.20
3,000	\$ 4.40
3,000	\$ 4.60
3,000	\$ 4.80
3,000	\$ 5.00

For the year ended May 31, 2020, there were 69,478 service-based restricted stock units granted, in addition to the 18,000 market-based restricted stock units that were granted. The total fair value of the restricted stock units, service and market based, at grant date was \$261,559. Of the service-based units outstanding, 113,561 units vested, and 16,770 units canceled. Restricted stock unit activity under the Company's stock-based compensation plans during the year ended May 31, 2020 is summarized as follows:

	Number of Units	Weighted average price at grant date	Aggregate Intrinsic Value
Non-vested restricted stock units - May 31, 2019	98,000	\$ 2.94	\$ 288,120
Restricted stock units granted	87,478	2.99	261,559
Restricted stock units vested	(113,561)	2.83	(321,378)
Restricted stock units forfeited	(16,770)	2.79	(46,788)
Non-vested restricted stock units - May 31, 2020	<u>55,147</u>	<u>\$ 3.28</u>	<u>\$ 180,882</u>

For the year ended May 31, 2020, total restricted stock unit compensation expense recognized was \$354,048 and has been recorded as general, administration and sales expense in the Consolidated Statements of Operations and the company will realize \$70,533 of expenses in future periods on RSUs granted prior to May 31, 2020.

NOTE 7 - WEIGHTED AVERAGE SHARES AND RECONCILIATION

The following table is a reconciliation of the numerators and denominators of the basic and diluted per share computations for loss from continuing operations for fiscal years ended May 31, 2020 and 2019, respectively:

	Net Income/(loss)	Weighted Avg Shares	Per Share Amount
Year ended May 31, 2020			
Basic earnings per share from continuing operations			\$ (0.47)
Loss available to stockholders	\$ (1,842,304)	3,939,833	
Effect of dilutive securities stock options	-	-	
Diluted earnings per share			
Loss available to common stockholders	<u>\$ (1,842,304)</u>	<u>\$ 3,939,833</u>	<u>\$ (0.47)</u>
Year ended May 31, 2019			
Basic earnings per share from continuing operations			\$ (0.37)
Loss available to stockholders	\$ (1,468,432)	4,005,795	
Effect of dilutive securities stock options	-	-	
Diluted earnings per share			
Loss available to common stockholders	<u>\$ (1,468,432)</u>	<u>\$ 4,005,795</u>	<u>\$ (0.37)</u>

Basic net loss from continuing operations per share is computed using the weighted average number of shares of Common Stock outstanding. Diluted net loss per share is computed using the weighted average number of shares of Common Stock outstanding, adjusted for dilutive incremental shares attributed to outstanding options to purchase Common Stock and restricted stock units vested but not issued. Common stock equivalents for stock options are computed using the treasury stock method. In periods in which a net loss is incurred, no common stock equivalents are included since they are antidilutive and as such all stock options outstanding are excluded from the computation of diluted net loss in those periods.

For the year ended May 31, 2020, potentially dilutive securities consisted of options of 22,500 shares of Common Stock at \$1.70 per share. Of these potentially dilutive securities, none of the shares of Common Stock underlying the options are included in the computation of diluted earnings per share because the Company incurred a net loss from continuing operations. In periods when a net loss is incurred in continuing operations, no Common Stock equivalents are included in the calculation of diluted net income or loss from discontinued operations or overall Company net income or loss since they are antidilutive. As such, all stock options outstanding are excluded from the computation of diluted net income in those periods.

On December 3, 2019, the Company announced that its Board of Directors authorized a share repurchase plan to buy up to \$2 million of its Common Stock. The Company intends to purchase shares from time to time through open market and private transactions in accordance with Securities and Exchange Commission rules. The plan is authorized through December 16, 2020. For the year ended May 31, 2020, the Company has repurchased 418,051 Shares, at an average price of \$3.23 per share, under its previously announced \$2 million share repurchase plan, which was done in accordance with a 10b5-1 plan.

On December 17, 2019, the Company acquired 365,490 shares of Common Stock (the "Shares") at \$3.25 per share from Walter Brown Pistor.

On January 31, 2020, the Company entered into an agreement with former director David Hudson to initiate a cashless exercise for 64,166 of his options, whereby the Company purchased 36,000 shares for \$3.25 per share from Mr. Hudson to fund the exercise of his remaining 28,166 shares.

NOTE 8 - 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 make further contributions in the form of a profit-sharing contribution or a discretionary contribution. The Company made matching contributions in conjunction with employee contributions to the plan totaling \$5,710 and \$40,336 during the years ended May 31, 2020 and 2019, respectively.

NOTE 9 - MAJOR CUSTOMERS

The Company had one customer whose revenue individually represented 33.8% and 31.7% of the Company's total net revenues for the years ended May 31, 2020 and 2019, respectively. The same customer accounted for 34.1% of accounts receivable as of May 31, 2020. Additionally, in 2019 there was an additional customer, who accounted for greater than 10% of total revenue, accounting for 11.9% of sales of the continuing operations.

NOTE 10 - DISCONTINUED OPERATIONS

On October 10, 2019, the Company entered into an agreement ("Purchase Agreement") to sell the Schmitt Dynamic Balance Systems ("SBS") business line to Tosei Engineering Corp. and Tosei America, Inc. (collectively "Tosei" or Buyer) for a purchase price of \$10,500,000 in cash. The transaction closed on November 22, 2019 and included certain assets held by the U.S. parent company and all the outstanding stock of the UK subsidiary, Schmitt Europe Limited. As a result, the financial position, results of operations, and cash flows relating to our SBS business line are reported as discontinued operations in the accompanying financial statements.

The consideration included \$9,940,000 in unrestricted cash from the Buyer at closing, plus \$420,000 to be placed into an escrow account, net of \$140,000 in minimum cash settled via the funds flow at closing. Remaining escrow funds become unrestricted after certain events are completed and after one year from closing. The Purchase Agreement requires an adjustment to purchase price after closing based on the difference between (a) the calculated amount of working capital at closing and (b) the target working capital of \$4,200,000. The closing working capital calculation resulted in \$107,000 in net proceeds paid from Buyer to Seller in February 2020.

In connection with the Purchase Agreement, the Company entered into a Transition Service Agreement (“TSA”) with the Buyer during the transition of certain accounting and treasury processes. The Company has collected approximately \$80,000 of cash belonging to the buyer via the TSA that is included in the cash and cash equivalents, accounts receivable, and other accrued liabilities at May 31, 2020.

The following table summarizes the consideration and gain recognized in the year ended May 31, 2020 associated with the sale of the SBS Business:

Purchase Price	\$ 10,500,000
Cash in SEL	69,157
Less:	
Net assets sold	\$ 4,460,177
Minimum cash	140,000
Transaction fees	453,287
Release of cumulative translation adjustment from OCI	455,848
Plus or minus:	
Closing adjustments	107,000
Pre-tax gain on sale	<u>\$ 5,166,845</u>
Income taxes	62,100
Gain on sale, net of income taxes	<u>\$ 5,104,745</u>

The following are the carrying amounts of assets and liabilities classified as held for sale and included as a part of discontinued operations:

	2020	2019
Accounts receivable, net	\$ -	\$ 1,365,114
Inventories	-	3,777,913
Prepaid expenses	-	49,357
Current assets held for sale	<u>\$ -</u>	<u>\$ 5,192,384</u>
Property and equipment, net	-	85,967
Noncurrent assets held for sale	<u>\$ -</u>	<u>\$ 85,967</u>
Accounts payable	\$ -	393,773
Accrued commissions	-	128,453
Accrued payroll liabilities	-	127,124
Customer deposits and prepayments	-	109,860
Other accrued liabilities	-	89,939
Current liabilities held for sale	<u>\$ -</u>	<u>\$ 849,149</u>
Net assets held for sale	<u>\$ -</u>	<u>\$ 4,429,202</u>

The following is a composition of the line items constituting income from discontinued operations:

	Fiscal year ended, May 31,	
	2020	2019
Net Sales	\$ 4,343,008	\$ 9,080,717
Cost of revenue	2,374,251	5,876,176
Gross profit	<u>1,968,757</u>	<u>3,204,541</u>
Operating expenses:		
General, administration and sales	1,252,222	2,771,254
Research and development	35,920	72,208
Total operating expenses	<u>1,288,142</u>	<u>2,843,462</u>
Operating income	680,615	361,079
Other income (expense), net	(63,904)	(85,972)
Income before Taxes	616,711	275,107
Provision for Income taxes	(1,423)	17,665
Net income from discontinued operations	<u>\$ 618,134</u>	<u>\$ 257,442</u>

NOTE 11 – SUBSEQUENT EVENTS

Ample Hills

On July 9, 2020, Ample Hills Acquisition LLC (“Buyer”), a New York limited liability company and wholly owned subsidiary of the Company, entered into an Asset Purchase Agreement (the “Agreement”), dated as of June 29, 2020, with Ample Hills Holdings, Inc., a Delaware corporation, Ample Hills Creamery, Inc., a New York corporation, and their subsidiaries (collectively, “Ample Hills”). The transactions contemplated by the Agreement (the “Transactions”) closed on July 9, 2020, the day after a sale order approving the Transactions was entered by the Bankruptcy Court (defined below). The Agreement provided that, upon the terms and subject to the conditions set forth therein, Ample Hills sold, transferred and assigned to Buyer, or one or more of its affiliates, the Acquired Assets (as defined in the Agreement) and Buyer, or one or more of its affiliates, assumed the Assumed Liabilities (as defined in the Agreement) for a purchase of \$1.0 million. The Asset Acquisition includes the following assets, among other things, Ample Hills’ equipment, inventory, and all intellectual property, including the names and marks of “AMPLE HILLS” and “AMPLE HILLS CREAMERY” and all derivatives thereof. Pursuant to the Agreement, Buyer also paid an additional approximately \$1.0 million to certain landlords of Ample Hills in exchange for the right to assume leases with such landlords. The Transactions were funded by the Company with cash on hand and will be accounted for in accordance with ASC 805 – Business Combinations.

The Ample Hills entities are debtors-in-possession under title 11 of the United States Code, 11 U.S.C. § 101 et seq. pursuant to voluntary petitions for relief filed under chapter 11 of the Bankruptcy Code on March 15, 2020 in the United States Bankruptcy Court for the Eastern District of New York (the “Bankruptcy Court”). The Transactions were conducted through a Bankruptcy Court-supervised process, subject to Bankruptcy Court-approved bidding procedures, approval of the Transactions by the Bankruptcy Court, and the satisfaction of certain closing conditions.

The Agreement contained certain customary representations and warranties made by each party. Buyer and Ample Hills agreed to various customary covenants, including, among others, covenants regarding the conduct of the Ample Hills businesses prior to the closing of the Transactions and covenants requiring Buyer and Ample Hills to use commercially reasonable efforts to obtain certain third-party and governmental consents, approvals or other authorizations required in connection with the Transactions.

Tender Offer

On July 21, 2020 – Schmitt Industries, Inc. announced the final results of its previously announced cash tender offer to purchase up to \$2.5 million of Schmitt’s common stock at a price per share not less than \$3.00 and not greater than \$3.25 (the “Offer”). Based on the final count by Broadridge Corporate Issuer Solutions, Inc., the depository for the Offer, the Company has accepted for purchase 72,159 shares of Schmitt’s common stock, for an aggregate cost of approximately \$234,516, excluding fees and expenses relating to the Offer. Since the Offer was not fully subscribed, no proration was required and all shares validly tendered and not withdrawn were accepted for purchase. The depository will promptly issue payment for the shares purchased.

The shares purchased represent approximately 1.9% of the Company’s common stock issued and outstanding as of July 20, 2020. Following consummation of the Offer, the Company has 3,784,554 shares of common stock outstanding.

Paycheck Protection Program Loan

On August 3, 2020, Schmitt Industries received loan proceeds in the amount of \$584,534 and returned \$264,476 of the funds received and Ample Hills received \$1,471,022, as part of the Paycheck Protection Program (“PPP”). The loan was granted as part of the Coronavirus Aid, Relief and Economic Security Act (“CARES Act”), and provides qualifying businesses for amounts up to 2.5 times of the average monthly payroll expenses of the qualifying business. The loans and accrued interest are forgivable after eight weeks, as long as the borrower uses the loan proceeds for eligible purposes, including payroll, benefits, rent and utilities, and maintains its payroll levels. The amount of loan forgiveness will be reduced if the borrower terminates employees or reduces salaries during the eight-week period. The PPP loan transactions will be accounted for in accordance with ASC 470.

The unforgiven portion of the PPP loan is payable over two years at an interest rate of 1%, with a deferral of payments for the first six months. The Company intends to use the proceeds for purposes consistent with the PPP. While the Company currently believes that its use of the loan proceeds will meet the conditions for forgiveness of the loan, we cannot assure you that we will not take actions that could cause the Company to be ineligible for forgiveness of the loan, in whole or in part.

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of

Schmitt Industries, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Schmitt Industries, Inc. and subsidiaries (the “Company”) as of May 31, 2020 and 2019, the related consolidated statements of operations and comprehensive income (loss), stockholders’ equity and cash flows for the years ended May 31, 2020 and 2019, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of May 31, 2020 and 2019, and the consolidated results of its operations and its cash flows for the years ended May 31, 2020 and 2019, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ Moss Adams LLP

Portland, Oregon
August 31, 2020

We have served as the Company’s auditor since 2009.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended (Exchange Act), is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. Our disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosures. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives, and management necessarily is required to use its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

An evaluation was carried out under the supervision and with the participation of the Company's management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report as defined in Exchange Act Rule 13a-15(e) and Rule 15d-15(e). Based on that evaluation, the CEO and CFO have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were not effective in ensuring that information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)). Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal controls over financial reporting based on the framework in *Internal Controls – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control – Integrated Framework*, our management concluded that our internal controls over financial reporting were not effective as of May 31, 2020.

Our CEO and CFO concluded that we have a material weakness in internal control over financial reporting due to deficiencies in the design and operation of internal controls over segregation of duties; and ineffective management review over the accounting reconciliations including accounting for inventory, accrued liabilities and taxes. The material weakness described above resulted in incorrectly accounting for transactions. Rule 12b-2 under the Exchange Act defines a material weakness as a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. As a result of the material weakness, our CEO and CFO have concluded that, as of May 31, 2020 the end of the period covered by this report, our disclosure controls and procedures were not effective at a reasonable assurance level.

Management's Remediation Initiatives

Management has developed a remediation plan in response to the material weakness identified, which includes:

- revising the design of existing controls, and designing and implementing additional key controls related to identifying and accounting for both routine and nonroutine transactions, which include protocols for engaging third-party accounting experts, where necessary;
- establishing protocols to ensure key controls operate on a timely basis to prevent and detect misstatement;
- providing additional GAAP technical accounting and internal control related training to both accounting and non-accounting departments.

We anticipate that these plans will be fully implemented and tested during 2021 such that our internal control deficiency will be remediated in that timeframe.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to SEC rules adopted in conformity with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Exchange Rules 13a-15(f) and 15d-15(f)) that occurred during the quarter ended May 31, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Certain information required by Part III is included in the Company's definitive Proxy Statement for its 2020 Annual Meeting of Shareholders ("Proxy Statement") and is incorporated herein by reference. The Proxy Statement will be filed pursuant to Regulation 14A of the Securities Exchange Act of 1934 not later than 120 days after the end of the fiscal year covered by this Report.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is included in the Company's Proxy Statement relating to the 2020 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is included in the Company's Proxy Statement relating to the 2020 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is included in the Company's Proxy Statement relating to the 2020 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this item is included in the Company's Proxy Statement relating to the 2020 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item is included in the Company's Proxy Statement relating to the 2020 Annual Meeting of Shareholders and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) *Financial Statements:*

- (1) Consolidated Balance Sheets as of May 31, 2020 and 2019

Consolidated Statements of Operations and Comprehensive Income (Loss) for the years ended May 31, 2020 and 2019

Consolidated Statements of Cash Flows for the years ended May 31, 2020 and 2019

Consolidated Statements of Stockholders' Equity for the years ended May 31, 2020 and 2019

Notes to Consolidated Financial Statements for the years ended May 31, 2020 and 2019

Reports of Independent 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 41 and 42 of the Exhibits filed with this report.

INDEX TO EXHIBITS

<u>Exhibits</u>	<u>Description</u>
<hr/>	
Exhibits marked with an asterisk (*) are incorporated by reference to exhibits or appendices previously filed with the Securities and Exchange Commission, as indicated by the references in brackets. All other exhibits are filed herewith.	
<hr/>	
*2.1	Asset Purchase Agreement, dated June 29, 2020, by and among Ample Hills Acquisition LLC, Ample Hills Holdings, Inc., Ample Hills Creamery, Inc., and the Ample Hills subsidiaries. [Form 8-K filed on July 15, 2020, Exhibit 2.1]
*3.1	Second Restated Articles of Incorporation of Schmitt Industries, Inc. [Form 10-K for the fiscal year ended May 31, 1998, Exhibit 3(i)]
*3.2	Articles of Amendment to Articles of Incorporation of Schmitt Industries, Inc. [Form 8-K filed on July 2, 2019, Exhibit 3.1]
*3.3	Second Restated Bylaws of Schmitt Industries, Inc. [Form 10-K for the fiscal year ended May 31, 1998, Exhibit 3(ii)]
*4.1	See exhibits 3.1 and 3.2 for provisions of the Articles of Incorporation and Bylaws defining the rights of security holders.
*4.2	Section 382 Rights Agreement, dated as of July 1, 2019, between Schmitt Industries, Inc. and Broadridge Corporate Issuer Solutions, Inc. [Form 8-K filed on July 2, 2019, Exhibit 4.1]
4.3	Description of Securities
*10.1†	Schmitt Industries, Inc. 2014 Equity Incentive Plan. [Appendix A to Schedule 14A filed on August 26, 2014]
*10.2	Asset Purchase Agreement and Stock Purchase Agreement dated October 9, 2019. [Form 8-K filed on October 11, 2019, Exhibit 1.01(A)]
*10.3	Transition Services Agreement, dated November 22, 2019 between the Company and Tosei America, Inc. [Form 8-K filed on November 27, 2019, Exhibit 99.1]
*10.4	Lease Agreement, dated November 22, 2019 between the Company and Tosei America, Inc. [Form 8-K filed on November 27, 2019, Exhibit 99.2]
*10.5†	Employment Agreement for Jamie Schmidt dated January 14, 2020. [Form 8-K filed on January 16, 2020, Exhibit 10.1]
10.6	[Promissory Note, dated August 3, 2020]
10.7	[Promissory Note, dated August 3, 2020]
*14.1	Code of Ethics and Business Conduct. [Form 10-K for the fiscal year ended May 31, 2004, Exhibit 14.1]
21.1	Subsidiaries of Schmitt Industries, Inc. as of May 31, 2020.
23.1	Consent of Independent Registered Public Accounting Firm.
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.

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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.
100.INS	XBRL Instance Document
100.SCH	XBRL Taxonomy Extension Schema Document
100.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
100.LAB	XBRL Taxonomy Extension Label Linkbase Document
100.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
100.DEF	XBRL Taxonomy Extension Definition Linkbase Document

† Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K.

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/ Michael R. Zapata
Michael R. Zapata
President and Chief Executive Officer

Date: August 31, 2020

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 31, 2020.

Signature	Title
<u> /s/ Michael R. Zapata </u> Michael R. Zapata	President and Chief Executive Officer (Principal Executive Officer)
<u> /s/ Jamie Schmidt </u> Jamie Schmidt	Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)
<u> /s/ Charles Davidson </u> Charles Davidson	Director
<u> /s/ Andrew P. Hines </u> Andrew P. Hines	Director
<u> /s/ Steven Strom </u> Steven Strom	Director

**DESCRIPTION OF THE REGISTRANT'S SECURITIES REGISTERED PURSUANT TO SECTION 12 OF THE SECURITIES EXCHANGE
ACT OF 1934**

Schmitt Industries, Inc. ("Schmitt" or the "Company") has authority to issue 22,000,000 shares of capital stock (the "Capital Stock"), consisting of 20,000,000 shares of common stock, no par value per share (the "Common Stock"), and 2,000,000 shares of preferred stock, no par value per share, of which 6,000 shares of preferred stock are currently designated as Series A Junior Participating Preferred Stock ("Series A Preferred Stock"). The following is a summary of the material terms of the Common Stock and the Series A Preferred Stock. This summary is qualified in its entirety by reference to Schmitt's Second Restated Articles of Incorporation, as amended (the "Charter"), Schmitt's Second Restated Bylaws (the "Bylaws"), and the Rights Agreement (as defined below), which are incorporated herein by reference as Exhibit 3.1 and 3.2, Exhibit 3.3 and Exhibit 4.2, respectively, to Schmitt's Annual Report on Form 10-K of which this exhibit is a part. Please read the Charter, the Bylaws, the Rights Agreement and applicable provisions of the Oregon Business Corporation Act (the "OBCA") for additional information.

The Company's Board of Directors (the "Board") has the power to classify and reclassify any of the shares of Capital Stock in accordance with the Charter and the OBCA.

Common Stock

General

The following is a summary description of the material terms of our Common Stock as provided in the (i) Charter and (ii) Bylaws. For a more detailed description of these securities, you should read the applicable provisions of the OBCA, Charter and Bylaws. As of July 31, 2020, there were 3,712,927 shares of Common Stock outstanding.

Subject to the prior rights of holders of all classes of stock at the time outstanding having prior rights as to dividends, the holders of Common Stock are entitled to receive such dividends, if any, as may from time to time be declared by the Board out of funds legally available therefor. Under our Bylaws, holders of Common Stock are entitled to one vote per share, and are entitled to vote upon such matters and in such manner as may be provided by law. Each matter, other than election of directors, properly presented to any meeting shall be decided by a majority of the votes cast on the matter. The Board is classified into three classes if the number of directors is four or more, with said classes to be as equal in number as may be possible, and the directors are elected by a plurality vote. Holders of Common Stock have no preemptive, conversion, redemption or sinking fund rights. Subject to the prior rights of holders of all classes of stock at the time outstanding having prior rights as to liquidation, holders of Common Stock, upon the liquidation, dissolution or winding up of the Company, are entitled to share equally and ratably in the remaining assets, if any, of the Company. The outstanding shares of Common Stock are, and the shares of Common Stock to be offered hereby when issued will be, fully paid and non-assessable. The rights, preferences and privileges of holders of Common Stock are subject to any series of preferred stock that the Company may authorize and issue in the future.

Anti-Takeover Provisions

Articles of Incorporation and Bylaws

Our Charter and Bylaws contain provisions that may delay or prevent a change in control of our company or changes in our management, including provisions that:

- authorize "blank check" preferred stock, which could be issued without shareholder approval and could have voting, liquidation, dividend, and other rights superior to our common stock;
 - create a classified board of directors whose members serve staggered three-year terms;
 - establish an advance notice procedure with regard to nominations of individuals for election to our board of directors;
 - provide that vacancies on our board of directors may be filled only by a majority of directors then in office, even though less than a quorum; and
-

- require a two-thirds vote of the holders of our Common Stock to amend specified provisions of our Charter and Bylaws.

These provisions, alone or together, could delay or prevent hostile takeovers and changes in control or changes in our management.

Oregon Business Combination Act

We are subject to the Oregon Business Combination Act, which prohibits an Oregon corporation from engaging in any business combination with any interested shareholder for three years after the date the shareholder became an interested shareholder, with the following exceptions:

- before the combination or transaction date, the board of directors of the corporation approved either the business combination or the transaction that resulted in the shareholder becoming an interested shareholder;
- upon completion of the transaction that resulted in the shareholder becoming an interested shareholder, the interested shareholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction began, excluding for purposes of determining the voting stock outstanding (but not the outstanding voting stock owned by the interested shareholder) those shares owned by (i) persons who are directors and also officers and (ii) employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or an exchange offer; or
- on or after that date, the business combination is approved by the board of directors and authorized at an annual or a special meeting of the shareholders, and not by written consent, by the affirmative vote of at least 66 2/3% of the outstanding voting stock that is not owned by the interested shareholder.

In general, the Oregon Business Combination Act defines “business combination” to include the following:

- any merger or consolidation involving the corporation or any direct or indirect majority-owned subsidiary of the corporation and the interested shareholder or any other corporation, partnership, unincorporated association or other entity if the merger or consolidation is caused by the interested shareholder and as a result of such merger or consolidation the transaction is not excepted as described above;
- any sale, transfer, pledge or other disposition (in one transaction or a series) of 10% or more of the assets of the corporation involving the interested shareholder;
- subject to certain exceptions, any transaction that results in the issuance or transfer by the corporation of any stock of the corporation to the interested shareholder;
- any transaction involving the corporation that has the effect of increasing the proportionate share of the stock or any class or series of the corporation beneficially owned by the interested shareholder; or
- the receipt by the interested shareholder of the benefit of any loans, advances, guarantees, pledges or other financial benefits by or through the corporation or any direct or indirect majority-owned subsidiary.

In general, the Oregon Business Combination Act defines an “interested shareholder” as an entity or a person who, together with the person’s affiliates and associates, beneficially owns, or within three years prior to the time of determination of interested shareholder status owned, 15% or more of the outstanding voting stock of the corporation.

Oregon Control Share Act

We are subject to the Oregon Control Share Act, which regulates the process by which a person may acquire control of certain Oregon-based corporations without the consent and cooperation of the corporation's board of directors. Under the Oregon Control Share Act a person who acquires voting stock in a transaction that results in the person holding more than 20%, 33 1/3% or 50% of the total voting power cannot vote the shares it acquires in the acquisition. This restriction does not apply if voting rights are given to the control shares by:

- the holders of a majority of the outstanding voting shares, excluding the control shares held by the acquirer and shares held by our officers and employee directors, and
- the holders of a majority of the outstanding voting shares, including the control shares held by such person and shares held by our officers and employee directors.

To retain the voting rights attached to acquired shares, these approvals are required at the time an acquirer's holdings first exceed 20% of the total voting power, and again at the times the acquiring person's holdings first exceed 33 1/3% and 50%. An acquiring person includes persons acting as a group.

The acquirer may, but is not required to, submit to the target company an "acquiring person statement" including specific information about the acquirer and its plans for the corporation. The acquiring person statement may also request that the corporation call a special meeting of shareholders to determine whether the control shares will be allowed to have voting rights. If the acquirer does not request a special meeting of shareholders, the issue of voting rights of control shares will be considered at the next annual or special meeting of shareholders that is held more than 60 days after the date of the acquisition of control shares. If the acquirer's control shares are allowed to have voting rights and represent a majority or more of all voting power, shareholders who do not vote in favor of voting rights for the control shares will have the right to receive the appraised fair value of their shares, which may not be less than the highest price paid per share by the acquirer for the control shares.

Shares are not deemed to be acquired in a control share acquisition if, among other things, they are acquired from the issuing corporation, or are issued pursuant to a plan of merger or exchange effected in compliance with the Oregon Business Corporation Act and the issuing corporation is a party to the merger or exchange agreement.

Transfer Agent and Registrar

The transfer agent and registrar for our Common Stock is Broadridge Corporate Issuer Solutions, Inc.

Listing

Our Common Stock is listed on the Nasdaq Capital Market under the symbol "SMIT."

Series A Junior Participating Preferred Stock and the Rights Agreement

General

The Company entered into a Section 382 Rights Agreement, dated July 1, 2019, with Broadridge Corporate Issuer Solutions, Inc., as Rights Agent (the "Rights Agreement") which seeks to protect stockholder value by attempting to diminish the risk that the Company's ability to use its net operating losses (collectively, the "NOLs") to reduce its U.S. taxable income and tax liabilities in future taxable periods (the "Tax Benefits") may become substantially limited. All capitalized terms used herein but not defined herein shall have the meanings ascribed to such terms in the Rights Agreement.

The Rights Agreement is intended to act as a deterrent to any person acquiring beneficial ownership of 4.9% or more of the Company's Common Stock, without the approval of the Board. Stockholders who beneficially own 4.9% or more of the outstanding Common Stock as of the close of business on July 1, 2019 will not trigger the Rights Agreement so long as they do not acquire beneficial ownership of additional shares of Common Stock representing 0.5% or more of the outstanding Common Stock (other than pursuant to a dividend or distribution paid or made by the Company on the outstanding shares of Common Stock or pursuant to a split or subdivision of the outstanding shares of Common Stock) at a time when they still beneficially own 4.9% or more of the outstanding Common Stock. In addition, the Board retains the sole discretion to exempt any person or group from the penalties imposed by the Rights Agreement.

The Rights.

The Board authorized the issuance of one right (a “Right”) for each outstanding share of Common Stock payable to stockholders of record as of the close of business on July 19, 2019 (the “Record Date”). One Right will also be issued together with each share of our Common Stock issued after the Record Date but before the Distribution Date (as defined below) and, in certain circumstances, after the Distribution Date. Subject to the terms, provisions and conditions of the Rights Agreement, if the Rights become exercisable, each Right would initially represent the right to purchase from the Company one one-thousandth of a share of Series A Preferred Stock for a purchase price of \$11.25 (the “Purchase Price”). If issued, each one-thousandth of a share of Series A Preferred Stock would give the stockholder approximately the same dividend, voting and liquidation rights as does one share of Common Stock. However, prior to exercise, a Right does not give its holder any rights as a stockholder of the Company, including, without limitation, any dividend, voting or liquidation rights.

Initial Exercisability.

The Rights will not be exercisable until the earlier of (i) ten business days after a public announcement that a person has become an “Acquiring Person” by acquiring beneficial ownership of 4.9% or more of outstanding Common Stock (or, in the case of a person that had beneficial ownership of 4.9% or more of the outstanding Common Stock as of the close of business on July 1, 2019, by obtaining beneficial ownership of any additional shares of Common Stock representing 0.5% or more of the shares of Common Stock then outstanding (other than pursuant to a dividend or distribution paid or made by the Company on the outstanding shares of the Common Stock or pursuant to a split or subdivision of the outstanding shares of Common Stock) at a time such person still beneficially owns 4.9% or more of the outstanding Common Stock), and (ii) ten business days (or such later date as may be specified by the Board prior to such time as any person becomes an Acquiring Person) after the commencement of a tender or exchange offer by or on behalf of a person that, if completed, would result in such person becoming an Acquiring Person (the “Distribution Date”).

Until the Distribution Date, Common Stock certificates or the ownership statements issued with respect to uncertificated shares of Common Stock will evidence the Rights. Any transfer of shares of Common Stock prior to the Distribution Date will also constitute a transfer of the associated Rights. After the Distribution Date, separate rights certificates will be issued and the Rights may be transferred other than in connection with the transfer of the underlying shares of Common Stock unless and until the Board has determined to effect an exchange pursuant to the Rights Agreement (as described below).

Flip-In Event.

In the event that a person becomes an Acquiring Person, each holder of a Right, other than Rights that are or, under certain circumstances, were beneficially owned by the Acquiring Person (which will thereupon become void), will thereafter have the right to receive upon exercise of a Right and payment of the Purchase Price, a number of shares of our Common Stock (or, in certain circumstances, cash, property or other securities of the Company) having a market value equal to two times the Purchase Price. However, Rights are subject to redemption and exchange at the option of the Company (as described below).

Flip-Out Event.

In the event that, at any time following a person becoming an Acquiring Person, (i) the Company engages in a merger or other business combination transaction in which the Company is not the surviving corporation; (ii) the Company engages in a merger or other business combination transaction in which the Company is the surviving corporation and the Common Stock is changed or exchanged; or (iii) 70% or more of the Company’s assets, cash flow or earning power is sold or transferred, each holder of a Right (except Rights which have previously been voided as set forth above) shall thereafter have the right to receive, upon exercise of the Right, common stock of the acquiring company having a value equal to two times the Purchase Price.

Redemption.

At any time until the earlier of July 1, 2022 and ten calendar days following the first date of public announcement that a person has become an Acquiring Person or that discloses information which reveals the existence of an Acquiring Person or such earlier date as a majority of the Board becomes aware of the existence of an Acquiring Person, the Board may redeem the Rights in whole, but not in part, at a price of \$0.001 per Right (the “Redemption Price”). The redemption of the Rights may be made effective at such time, on such basis and with such conditions as the Board in its sole discretion may establish. Immediately upon any redemption of the Rights, the right to exercise the Rights will terminate and the only right of the holders of Rights will be to receive the Redemption Price.

Exchange.

At any time after a person becomes an Acquiring Person, the Board may, at its option, exchange the Rights (other than Rights that have become void), in whole or in part, at an exchange ratio of one share of Common Stock, or a fractional share of Series A Preferred Stock (or of a share of a similar class or series of the Company's preferred stock having similar rights, preferences and privileges) of equivalent value, per Right (subject to adjustment). Immediately upon an exchange of any Rights, the right to exercise such Rights will terminate and the only right of the holders of Rights will be to receive the number of shares of Common Stock (or fractional share of Series A Preferred Stock or of a share of a similar class or series of the Company's preferred stock having similar rights, preferences and privileges) equal to the number of such Rights held by such holder multiplied by the exchange ratio.

Certain Preferred Stock Provisions.

Each one one-thousandth of a share of Series A Preferred Stock, if issued: (i) will be junior to any other series of preferred stock the Company may issue (unless otherwise provided in the terms of such other series), (ii) will entitle holders to preferential cumulative quarterly dividends in an amount per share of Series A Preferred Stock equal to the greater of (a) \$1 or (b) 1,000 times the aggregate dividends, if any, declared on one share of Common Stock, (iii) will entitle holders upon liquidation (voluntary or otherwise) to receive \$1,000 per share of Series A Preferred Stock plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, and (iv) will entitle holders to a per share payment equal to the payment made on one share of Common Stock, if shares of the Common Stock are exchanged via merger, consolidation, or a similar transaction. Because of the nature of the Series A Preferred Stock's dividend, liquidation and voting rights, the value of one one-thousandth of a share of Series A Preferred Stock purchasable upon exercise of each Right should approximate the value of one share of Common Stock.

Expiration.

The Rights and the Rights Agreement will expire on the earliest of (i) July 1, 2022, (ii) the time at which the Rights are redeemed pursuant to the Rights Agreement, (iii) the time at which the Rights are exchanged in full pursuant to the Rights Agreement, (iv) the date that the Board determines that the Rights Agreement is no longer necessary for the preservation of material valuable Tax Benefits, (v) the beginning of a taxable year of the Company to which the Board determines that no Tax Benefits may be carried forward, and (vi) a determination by the Board, prior to the time any Person becomes an Acquiring Person, that the Rights Agreement and the Rights are no longer in the best interests of the Company and its stockholders.

Anti-Dilution Provisions.

The Board may adjust the Purchase Price, the number of shares of Series A Preferred Stock or other securities or assets issuable and the number of outstanding Rights to prevent dilution that may occur as a result of certain events, including among others, a stock dividend, a stock split or a reclassification of the Series A Preferred Stock or Common Stock. With certain exceptions, no adjustments to the Purchase Price will be required until cumulative adjustments amount to at least 1% of the Purchase Price.

Amendments.

For so long as the Rights are redeemable, the Board may supplement or amend any provision of the Rights Agreement in any respect without the approval of the holders of the Rights. From and after the time the Rights are no longer redeemable, the Board may supplement or amend the Rights Agreement only to cure an ambiguity, to alter time period provisions, to correct inconsistent provisions, or to make any additional changes to the Rights Agreement which the Company may deem necessary or desirable, but only to the extent that those changes do not impair or adversely affect any Rights holder (other than an Acquiring Person or any Affiliate or Associate of an Acquiring Person or certain of their transferees) and do not result in the Rights again becoming redeemable or the Rights Agreement again becoming amendable other than in accordance with this sentence.

Promissory Note

Date	Loan Amount	Interest Rate
July 30, 2020	\$1,471,022.00	1.00% fixed per annum

This Promissory Note ("Note") sets forth and confirms the terms and conditions of a term loan to Ample Hills Acquisition LLC (whether one or more than one, "Borrower") from Bank of America, N.A., a national banking association having an address of P.O. Box 15220, Wilmington, DE 19886-5220 (together with its agents, affiliates, successors and assigns, the "Bank") for the Loan Amount and at the Interest Rate stated above (the "Loan"). The Loan is made pursuant to the Paycheck Protection Program under the Coronavirus Aid, Relief, and Economic Security Act (as amended by the Paycheck Protection Program Flexibility Act of 2020 and as otherwise amended from time to time, the "CARES Act"). The funding of the Loan is conditioned upon approval of Borrower's application for the Loan and Bank's receiving confirmation from the SBA that Bank may proceed with the Loan. The date on which the funding of the Loan takes place is referred to as the "Funding Date". The "Deferment Period" commences on the Funding Date and ends on the earlier of (i) the date on which the amount of forgiveness as determined under section 1106 of the CARES Act is remitted to the Bank (the "Forgiveness Remittance Date"), (ii) the date on which Bank provides notice to Borrower that Bank has determined Borrower is not entitled to forgiveness and (iii) the Forgiveness Period Outside Date (as defined below) if Borrower fails to apply for forgiveness on or before such date. Promptly after the end of the 'covered period' as determined in accordance with Section 1106 of the CARES Act, and no later than ten months after the last day of the Forgiveness Covered Period (the "Forgiveness Period Outside Date"), Borrower shall apply to Bank for loan forgiveness. If the SBA confirms full and complete forgiveness of the unpaid balance of the Loan, and reimburses Bank for the total outstanding balance, principal and interest, Borrower's obligations under the Loan will be deemed fully satisfied and paid in full. If the SBA does not confirm forgiveness of the Loan, or only partly confirms forgiveness of the Loan, or Borrower fails to apply for loan forgiveness by the Forgiveness Period Outside Date, Borrower will be obligated to repay to the Bank the total outstanding balance remaining due under the Loan, including principal and interest (the "Loan Balance"), and in such case, Bank will establish the terms for repayment of the Loan Balance in a separate letter to be provided to Borrower, which letter will set forth the Loan Balance, the amount of each monthly payment, the interest rate (not in excess of a fixed rate of one per cent (1.00%) per annum), the term of the Loan, and the applicable maturity date. The applicable maturity date will be the maturity date as established by the SBA. If the SBA establishes a range of allowable maturity dates, the lowest term in the range will apply (unless extended by the Bank in its discretion); and if the SBA does not establish a maturity date or range of allowable maturity dates, the maturity date will be five (5) years. No principal or interest payments will be due prior to the end of the Deferment Period, though interest will accrue during the Deferment Period. Borrower promises, covenants and agrees with Bank to repay the Loan in accordance with the terms for repayment, including the maturity date as determined in accordance with the procedures described above, as set forth in that letter (the "Repayment Letter"). Payments greater than the monthly payment or additional payments may be made at any time without a prepayment penalty but shall not relieve Borrower of its obligations to pay the next succeeding monthly payment.

In consideration of the Loan received by Borrower from Bank, Borrower agrees as follows:

- 1. DEPOSIT ACCOUNT/USE OF LOAN PROCEEDS:** Borrower is required to maintain a deposit account with Bank of America, N.A. (the "Deposit Account") until the Loan is either forgiven in full or the Loan is fully paid by Borrower. Borrower acknowledges and agrees that the proceeds of the Loan shall be deposited by Bank into the Deposit Account. The Loan proceeds are to not be used by Borrower for any illegal purpose and Borrower represents to the Bank that it will derive material benefit, directly and indirectly, from the making of the Loan.
- 2. DIRECT DEBIT.** If all or any portion of the Loan is not forgiven and a Loan Balance remains after the last day of the Deferment Period (or, if Borrower does not apply for forgiveness, on the Forgiveness Period Outside Date), Borrower agrees that on the due date of any amount due as set forth in the Repayment Letter, Bank will debit the amount due from the Deposit Account established by Borrower in connection with this Loan. Should there be insufficient funds in the Deposit Account to pay all such sums when due, the full amount of such deficiency shall be immediately due and payable by Borrower.
- 3. INTEREST RATE:** Bank shall charge interest on the unpaid principal balance of the Loan at the interest rate set forth above under "Interest Rate" from the Funding Date until the date that the Loan is paid in full. For the avoidance of doubt, any interest that accrued prior to the Forgiveness Remittance Date but is not repaid by the SBA in connection with remittance of the forgiven amount of the Loan on the Forgiveness Remittance Date shall be payable by you in accordance with the Repayment Letter.
- 4. REPRESENTATIONS, WARRANTIES AND COVENANTS.** (1) Borrower represents and warrants to Bank, and covenants and agrees with Bank, that: (i) Borrower has read the statements included in the Application, including the Statements Required by Law and Executive Orders, and Borrower understands them. (ii) Borrower was and remains eligible to receive a loan under the rules and guidance issued by the SBA implementing the Paycheck Protection Program under Division A, Title I of the CARES Act (the "Paycheck Protection Program Rule") in effect at the time Borrower submitted to Bank its Paycheck Protection Program Application Form (the "Application"). (iii) Borrower (a) is an independent contractor, eligible self-employed individual, or sole proprietor or (b) employs no more than the greater of 500 employees or, if applicable, the size standard in number of employees established by the SBA in 13 C.F.R. 121.201 for Borrower's industry. (iv) Borrower will comply whenever applicable, with the civil rights and other limitations in the Application. (v) All proceeds of the Loan will be used only for business-related purposes as specified in the Application and consistent with the Paycheck Protection Program Rule. (vi) To the extent feasible, Borrower will purchase only American-made equipment and products. (vii) Borrower is not engaged in any activity that is illegal under federal, state or local law. (viii) Borrower certifies that any loan received by Borrower under Section 7(b)(2) of the Small Business Act between January 31, 2020 and April 3, 2020 that will remain outstanding after funding of this Loan was for a purpose other than paying payroll costs and other allowable uses of loan proceeds under the Paycheck Protection Program Rule. (ix) Borrower was in operation on February 15, 2020 and had employees for whom Borrower paid salaries and payroll taxes or paid independent contractors (as reported on Form(s) 1099-MISC). (x) The current economic uncertainty makes the request

for the Loan necessary to support the ongoing operations of Borrower (as such representation is further explained in SBA guidance with respect to the Paycheck Protection Program). (xi) All proceeds of the Loan will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments, as specified under the Paycheck Protection Program Rule and Borrower acknowledges that if the funds are knowingly used for unauthorized purposes, the federal government may hold Borrower and/or Borrower's authorized representative legally liable, such as for charges of fraud. (xii) Borrower has provided Bank true, correct and complete information demonstrating that Borrower had employees for whom Borrower paid salaries and payroll taxes on or around February 15, 2020. (xiii) Borrower has provided to Bank all documentation available to Borrower on a reasonable basis verifying the dollar amounts of average monthly payroll costs for the calendar year 2019, which documentation shall include, as applicable, copies of payroll processor records, payroll tax filings and/or Form 1099-MISC. (xiv) Borrower will promptly provide to Bank (a) any additional documentation that Bank requests in order to verify payroll costs and (b) documentation verifying the number of full-time equivalent employees on payroll as well as the dollar amounts of payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities for the applicable "covered period" (as determined in accordance with Section 1106 of the CARES Act) following the Loan, including all such documentation required under the forgiveness application promulgated by the SBA. (xv) Borrower acknowledges that (a) loan forgiveness will be provided by the SBA for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities, and at least 60% of the covered loan amount must be used for payroll costs. (xvi) During the period beginning on February 15, 2020 and ending on December 31, 2020, Borrower has not and will not receive any other loan under the Paycheck Protection Program, except for any increase that was expressly permitted under the Paycheck Protection Program Rule. (xvii) Borrower certifies that the information provided in the Application and the information that Borrower provided in all supporting documents and forms is true and accurate in all material respects. Borrower acknowledges that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law, including under 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to \$250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than \$5,000; and, if submitted to a Federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than \$1,000,000. (xviii) Borrower understands, acknowledges and agrees that Bank can share any tax information received from Borrower or any Owner with SBA's authorized representatives, including authorized representatives of the SBA Office of Inspector General, for the purpose of compliance with SBA Loan Program Requirements and all SBA reviews. (xix) Neither Borrower nor any Owner, is presently suspended, debarred, proposed for debarment, declared ineligible, voluntarily excluded from participation in this transaction by any Federal department or agency, or presently involved in any bankruptcy. (xx) Neither Borrower, nor any Owner, nor any business owned or controlled by any of them, ever obtained a direct or guaranteed loan from SBA or any other Federal agency that is currently delinquent or has defaulted in the last 7 years and caused a loss to the government. (xxi) Neither Borrower, nor any Owner, is an owner of any other business or has common management with any other business, except as disclosed to the Bank in connection with the Borrower's Application. (xxii) Borrower did not receive an SBA Economic Injury Disaster Loan between January 31, 2020 and April 3, 2020, except as disclosed to the Bank in connection with the Borrower's Application. (xxiii) Neither Borrower (if an individual), nor any individual owning 20% or more of the equity of Borrower (each, an "Owner"), is subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction, or presently incarcerated, on probation or parole. (xxiv) Neither Borrower (if an individual), nor any Owner, has been incarcerated, on probation, on parole; presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction; or has been convicted of a felony involving fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance within the last five years or any other felony within the last year. (xxv) The United States is the principal place of residence for all employees of Borrower included in Borrower's payroll calculation included in the Application. (xxvi) The Borrower correctly indicated on its Application whether it is a franchise that is listed in the SBA's franchise directory. (xxvii) If Borrower is claiming an exemption from all SBA affiliation rules applicable to Paycheck Protection Program loan eligibility under the religious exemption to the affiliation rules, Borrower has made a reasonable, good faith determination that it qualifies for such religious exemption under 13 C.F.R. 121.103(b)(10), which provides that "[t]he relationship of a faith-based organization to another organization is not considered an affiliation with the other organization...if the relationship is based on a religious teaching or belief or otherwise constitutes a part of the exercise of religion." (2) At all times during the term of the Loan, Borrower represents and warrants to the Bank, that (i) if Borrower is anything other than a natural person, it is duly formed and existing under the laws of the state or other jurisdiction where organized; (ii) this Note, and any instrument or agreement required under this Note, are within Borrower's powers, have been duly authorized, and do not conflict with any of its organizational papers; (iii) the information included in the Beneficial Ownership Certification most recently provided to the Bank, if applicable, is true and correct in all respects; and (iv) in each state in which Borrower does business, it is properly licensed, in good standing, and, where required, in compliance with fictitious name (e.g. trade name or d/b/a) statutes. **IF THE FUNDING DATE IS AFTER THE DATE OF THIS NOTE, BORROWER AGREES THAT BORROWER SHALL BE DEEMED TO HAVE REPEATED AND REISSUED, IMMEDIATELY PRIOR TO THE FUNDING ON THE FUNDING DATE, THE REPRESENTATIONS, WARRANTIES, COVENANTS AND AGREEMENTS SET FORTH ABOVE IN THIS PARAGRAPH.**

5. **EVENTS OF DEFAULT:** If all or any portion of the Loan is not forgiven and a Loan Balance remains after the first to occur of the Forgiveness Remittance Date and the Forgiveness Period Outside Date, then from the date the Repayment Letter is sent to Borrower until the Loan Balance is fully paid, the occurrence and continuation of any of the following events shall constitute a default hereunder: (i) insolvency, bankruptcy, dissolution, issuance of an attachment or garnishment against Borrower; (ii) failure to make any payment when due under the Loan or any or all other loans made by Bank to Borrower, and such failure continues for ten (10) days after it first became due; (iii) failure to provide current financial information promptly upon request by Bank; (iv) the making of any false or materially misleading statement on any application or any financial statement for the Loan or for any or all other loans made by Bank to Borrower; (v) Bank in good faith believes the prospect of payment under the Loan or any or all other loans made by Bank to Borrower is impaired; (vi) Borrower under or in connection with the Loan or any or all other loans made by Bank to Borrower fails to timely and properly observe, keep or perform any term, covenant, agreement, or condition herein or therein; (vii) default shall be made with respect to any other indebtedness for borrowed money of Borrower, if the default is a failure to pay at maturity or if the effect of such default is to accelerate the maturity of such indebtedness for borrowed money or to permit the holder or obligee thereof or other party thereto to cause any such indebtedness for borrowed money to become due prior to its stated maturity; (viii) the Bank in its sole discretion determines in good faith that an event has occurred that materially and adversely affects Borrower; (ix) any change shall occur in the ownership of the Borrower; (x) permanent cessation of Borrower's business operations; (xi) Borrower, if an individual, dies, or becomes disabled, and such disability prevents the Borrower from continuing to operate its business; (xii) Bank receives notification or is otherwise made aware that Borrower, or any affiliate of Borrower, is listed as or appears on any lists of known or suspected terrorists or terrorist organizations provided to Bank by the U.S. government under the USA Patriot Act of 2001; and (xiii) Borrower fails to maintain the Deposit Account with the Bank. In addition, a default shall occur immediately hereunder if the SBA demands repayment in full by Borrower of the Loan

prior to the maturity date hereof for any reason, including, without limitation, as a result of an SBA determination that Borrower was ineligible for this Loan for any reason, including as a result of an improper necessity certification, eligibility certification or other certification in the Application for the Loan.

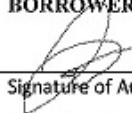
6. **REMEDIES:** Upon the occurrence of a default described in Section 5 above, all or any portion of the entire amount owing on the Loan, and any and all other loans made by Bank to Borrower, shall, at Bank's option, become immediately due and payable without demand or notice. Upon a default, Bank may exercise any other right or remedy available to it at law or in equity. All persons included in the term "Borrower" are jointly and severally liable for repayment, regardless of to whom any advance of credit was made. Borrower shall pay any costs Bank may incur including without limitation reasonable attorney's fees and court costs should the Loan and/or any and all other loans made by Bank to Borrower be referred to an attorney for collection to the extent permitted under applicable state law. **EACH PERSON INCLUDED IN THE TERM BORROWER WAIVES ALL SURETYSHIP AND OTHER SIMILAR DEFENSES TO THE FULL EXTENT PERMITTED BY APPLICABLE LAW.**
7. **CREDIT INVESTIGATION:** If the Loan is not forgiven and a Loan Balance remains, then from the date the Repayment Letter is sent to Borrower until the Loan Balance is fully paid, Borrower authorizes Bank and any of its affiliates at any time to make whatever credit investigation Bank deems is proper to evaluate Borrower's credit, financial standing and employment and Borrower authorizes Bank to exchange Borrower's credit experience with credit bureaus and other creditors Bank reasonably believes are doing business with Borrower. Borrower also agrees to furnish Bank with any financial statements Bank may request at any time and in such detail as Bank may require.
8. **NOTICES:** Borrower's request for Loan forgiveness, and the documentation that must accompany that request, shall be submitted to Bank by transmitting the communication to the electronic address, website, or other electronic transmission portal provided by Bank to Borrower. Otherwise, all notices required under this Note shall be personally delivered or sent by first class mail, postage prepaid, or by overnight courier, to the addresses on the signature page of this Note, or sent by facsimile to the fax number(s) listed on the signature page, or to such other addresses as the Bank and the Borrower may specify from time to time in writing (any such notice a "Written Notice"). Written Notices shall be effective (i) if mailed, upon the earlier of receipt or five (5) days after deposit in the U.S. mail, first class, postage prepaid, (ii) if telecopied, when transmitted, or (iii) if hand-delivered, by courier or otherwise (including telegram, lettergram or mailgram), when delivered. In lieu of a Written Notice, notices and/or communications from the Bank to the Borrower may, to the extent permitted by law, be delivered electronically (i) by transmitting the communication to the electronic address provided by the Borrower or to such other electronic address as the Borrower may specify from time to time in writing, or (ii) by posting the communication on a website and sending the Borrower a notice to the Borrower's postal address or electronic address telling the Borrower that the communication has been posted, its location, and providing instructions on how to view it (any such notice, an "Electronic Notice"). Electronic Notices shall be effective when presented to the Borrower, or is sent to the Borrower's electronic address or is posted to the Bank's website. To retain a copy for your records, please download and print or save a copy to your device.
9. **CHOICE OF LAW; JURISDICTION; VENUE.** (1) At all times that Bank is the holder of this Note, except to the extent that any law of the United States may apply, this Note shall be governed and interpreted according to the internal laws of the state of Borrower's principal place of business (the "Governing Law State"), without regard to any choice of law, rules or principles to the contrary. However, the charging and calculating of interest on the obligations under this Note shall be governed by, construed and enforced in accordance with the laws of the state of North Carolina and applicable federal law. Nothing in this paragraph shall be construed to limit or otherwise affect any rights or remedies of Bank under federal law. Borrower and Bank agree and consent to be subject to the personal jurisdiction of any state or federal court located in the Governing Law State so that trial shall only be conducted by a court in that state. (2) Notwithstanding the foregoing, when SBA is the holder, this Note will be interpreted and enforced under federal law, including SBA regulations. Lender or SBA may use state or local procedures for filing papers, recording documents, giving notice, foreclosing liens, and other purposes. By using such procedures, SBA does not waive any federal immunity from state or local control, penalty, tax, or liability. As to this Note, Borrower may not claim or assert against SBA any local or state law to deny any obligation, defeat any claim of SBA, or preempt federal law.
10. **MISCELLANEOUS.** The Loan may be sold or assigned by Bank without notice to Borrower. Borrower may not assign the Loan or its rights hereunder to anyone without Bank's prior written consent. If any provision of this Note is contrary to applicable law or is found unenforceable, such provision shall be severed from this Note without invalidating the other provisions thereof. Bank may delay enforcing any of its rights under this Note without losing them, and no failure or delay on the part of Bank in exercising any right, power or privilege hereunder shall operate as a waiver thereof; nor shall any single or partial exercise of any right, power or privilege hereunder preclude any other or future exercise thereof or the exercise of any other right, power or privilege. Bank, by its acceptance hereof, and the making of the Loan and Borrower understand and agree that this Note constitutes the complete understanding between them. This Note shall be binding upon Borrower, and its successors and assigns, and inure to the benefit of Bank and its successors and assigns. This Note automatically may be amended from time to time to comply with any express requirements under any amendment of the CARES Act or any rules or guidance promulgated with respect thereto to the extent applicable to this Note, in each case without the requirement of any consent of or notice to Borrower.
11. **BORROWING AUTHORIZED.** The signer for Borrower represents, covenants and warrants to Bank that he or she is certified to borrow for the Borrower and is signing this Note as the duly authorized sole proprietor, owner, sole shareholder, officer, member, managing member, partner, trustee, principal, agent or representative of Borrower, and further acknowledges and confirms to Bank that by said signature he or she has read and understands all of the terms and provisions contained in this Note and agrees and consents to be bound by them. This Note and any instrument or agreement required herein, are within the Borrower's powers, have been duly authorized, and do not conflict with any of its organizational papers. The individuals signing this Agreement on behalf of each Borrower are authorized to sign such documents on behalf of such entities. For purposes of this Note only, the Bank may rely upon and accept the authority of only one signer on behalf of the Borrower, and for this Note, this resolution supersedes and replaces any prior and existing contrary resolution provided by Borrower to Bank.
12. **ELECTRONIC COMMUNICATIONS AND SIGNATURES.** This Note and any document, amendment, approval, consent, information, notice, certificate, request, statement, disclosure or authorization related to this Note (each a "Communication"), including Communications required to be in writing, may, if agreed by the Bank, be in the form of an Electronic Record and may be executed using Electronic Signatures, including, without limitation, facsimile and/or .pdf. The Borrower agrees that any Electronic Signature (including, without limitation, facsimile or .pdf) on or associated with any Communication shall be valid and binding on the Borrower to the same extent as a manual, original signature, and that any

Communication entered into by Electronic Signature, will constitute the legal, valid and binding obligation of the Borrower enforceable against the Borrower in accordance with the terms thereof to the same extent as if a manually executed original signature was delivered to the Bank. Any Communication may be executed in as many counterparts as necessary or convenient, including both paper and electronic counterparts, but all such counterparts are one and the same Communication. For the avoidance of doubt, the authorization under this paragraph may include, without limitation, use or acceptance by the Bank of a manually signed paper Communication which has been converted into electronic form (such as scanned into PDF format), or an electronically signed Communication converted into another format, for transmission, delivery and/or retention. The Bank may, at its option, create one or more copies of any Communication in the form of an imaged Electronic Record ("Electronic Copy"), which shall be deemed created in the ordinary course of the Bank's business, and destroy the original paper document. All Communications in the form of an Electronic Record, including an Electronic Copy, shall be considered an original for all purposes, and shall have the same legal effect, validity and enforceability as a paper record. Notwithstanding anything contained herein to the contrary, the Bank is under no obligation to accept an Electronic Signature in any form or in any format unless expressly agreed to by the Bank pursuant to procedures approved by it; provided, further, without limiting the foregoing, (a) to the extent the Bank has agreed to accept such Electronic Signature, the Bank shall be entitled to rely on any such Electronic Signature without further verification and (b) upon the request of the Bank any Electronic Signature shall be promptly followed by a manually executed, original counterpart. For purposes hereof, "Electronic Record" and "Electronic Signature" shall have the meanings assigned to them, respectively, by 15 USC §7006, as it may be amended from time to time.

13. **CONVERSION TO PAPER ORIGINAL.** At the Bank's discretion the authoritative electronic copy of this Note ("Authoritative Copy") may be converted to paper and marked as the original by the Bank (the "Paper Original"). Unless and until the Bank creates a Paper Original, the Authoritative Copy of this Agreement: (1) shall at all times reside in a document management system designated by the Bank for the storage of authoritative copies of electronic records, and (2) is held in the ordinary course of business. In the event the Authoritative Copy is converted to a Paper Original, the parties hereto acknowledge and agree that: (1) the electronic signing of this Agreement also constitutes issuance and delivery of the Paper Original, (2) the electronic signature(s) associated with this Agreement, when affixed to the Paper Original, constitutes legally valid and binding signatures on the Paper Original, and (3) the Borrower's obligations will be evidenced by the Paper Original after such conversion.
14. **BORROWER ATTESTATION.** Borrower attests and certifies to Bank that it has not provided false or misleading information or statements to the SBA or the Bank in its application for the Loan, and that the certifications, representations, warranties, and covenants made to the Bank in this Note and elsewhere relating to the Loan are true, accurate, and correct. Borrower further attests and certifies to Bank that it has read, understands, and acknowledges that the Loan is being made under the CARES Act, and any use of the proceeds of the Loan other than as permitted by the CARES Act and related rules and guidance, or any false or misleading information or statements provided to the Bank in its application for the Loan or in this Note may subject the Borrower to criminal and civil liability under applicable state and federal laws and regulations, including but not limited to, the False Claims Act, 31 U.S.C. Section 3729, et. seq. Borrower further acknowledges and understands that this Note is not valid and effective until and unless Borrower's application for the Loan is approved and Bank's receiving confirmation from the SBA that Bank may proceed with the Loan.

IN WITNESS WHEREOF, I, the authorized representative of the Borrower, hereto have caused this Promissory Note to be duly executed as of the date set forth below.

BORROWER: Ample Hills Acquisition LLC



Signature of Authorized Representative of Borrower

Jamie Schmidt

Print Name

Authorized Representative

Title

STREET ADDRESS: 2765 NW Nicolai St

CITY/STATE/ZIP CODE: Portland, OR 97210-1818

Promissory Note

Date	Loan Amount	Interest Rate
July 30, 2020	\$588,534.00	1.00% fixed per annum

This Promissory Note ("Note") sets forth and confirms the terms and conditions of a term loan to Schmitt Industries Inc (whether one or more than one, "Borrower") from Bank of America, N.A., a national banking association having an address of P.O. Box 15220, Wilmington, DE 19886-5220 (together with its agents, affiliates, successors and assigns, the "Bank") for the Loan Amount and at the Interest Rate stated above (the "Loan"). The Loan is made pursuant to the Paycheck Protection Program under the Coronavirus Aid, Relief, and Economic Security Act (as amended by the Paycheck Protection Program Flexibility Act of 2020 and as otherwise amended from time to time, the "CARES Act"). The funding of the Loan is conditioned upon approval of Borrower's application for the Loan and Bank's receiving confirmation from the SBA that Bank may proceed with the Loan. The date on which the funding of the Loan takes place is referred to as the "Funding Date". The "Deferment Period" commences on the Funding Date and ends on the earlier of (i) the date on which the amount of forgiveness as determined under section 1106 of the CARES Act is remitted to the Bank (the "Forgiveness Remittance Date"), (ii) the date on which Bank provides notice to Borrower that Bank has determined Borrower is not entitled to forgiveness and (iii) the Forgiveness Period Outside Date (as defined below) if Borrower fails to apply for forgiveness on or before such date. Promptly after the end of the 'covered period' as determined in accordance with Section 1106 of the CARES Act, and no later than ten months after the last day of the Forgiveness Covered Period (the "Forgiveness Period Outside Date"), Borrower shall apply to Bank for loan forgiveness. If the SBA confirms full and complete forgiveness of the unpaid balance of the Loan, and reimburses Bank for the total outstanding balance, principal and interest, Borrower's obligations under the Loan will be deemed fully satisfied and paid in full. If the SBA does not confirm forgiveness of the Loan, or only partly confirms forgiveness of the Loan, or Borrower fails to apply for loan forgiveness by the Forgiveness Period Outside Date, Borrower will be obligated to repay to the Bank the total outstanding balance remaining due under the Loan, including principal and interest (the "Loan Balance"), and in such case, Bank will establish the terms for repayment of the Loan Balance in a separate letter to be provided to Borrower, which letter will set forth the Loan Balance, the amount of each monthly payment, the interest rate (not in excess of a fixed rate of one per cent (1.00%) per annum), the term of the Loan, and the applicable maturity date. The applicable maturity date will be the maturity date as established by the SBA. If the SBA establishes a range of allowable maturity dates, the lowest term in the range will apply (unless extended by the Bank in its discretion); and if the SBA does not establish a maturity date or range of allowable maturity dates, the maturity date will be five (5) years. No principal or interest payments will be due prior to the end of the Deferment Period, though interest will accrue during the Deferment Period. Borrower promises, covenants and agrees with Bank to repay the Loan in accordance with the terms for repayment, including the maturity date as determined in accordance with the procedures described above, as set forth in that letter (the "Repayment Letter"). Payments greater than the monthly payment or additional payments may be made at any time without a prepayment penalty but shall not relieve Borrower of its obligations to pay the next succeeding monthly payment.

In consideration of the Loan received by Borrower from Bank, Borrower agrees as follows:

1. **DEPOSIT ACCOUNT/USE OF LOAN PROCEEDS:** Borrower is required to maintain a deposit account with Bank of America, N.A. (the "Deposit Account") until the Loan is either forgiven in full or the Loan is fully paid by Borrower. Borrower acknowledges and agrees that the proceeds of the Loan shall be deposited by Bank into the Deposit Account. The Loan proceeds are to not be used by Borrower for any illegal purpose and Borrower represents to the Bank that it will derive material benefit, directly and indirectly, from the making of the Loan.
2. **DIRECT DEBIT.** If all or any portion of the Loan is not forgiven and a Loan Balance remains after the last day of the Deferment Period (or, if Borrower does not apply for forgiveness, on the Forgiveness Period Outside Date), Borrower agrees that on the due date of any amount due as set forth in the Repayment Letter, Bank will debit the amount due from the Deposit Account established by Borrower in connection with this Loan. Should there be insufficient funds in the Deposit Account to pay all such sums when due, the full amount of such deficiency shall be immediately due and payable by Borrower.
3. **INTEREST RATE:** Bank shall charge interest on the unpaid principal balance of the Loan at the interest rate set forth above under "Interest Rate" from the Funding Date until the date that the Loan is paid in full. For the avoidance of doubt, any interest that accrued prior to the Forgiveness Remittance Date but is not repaid by the SBA in connection with remittance of the forgiven amount of the Loan on the Forgiveness Remittance Date shall be payable by you in accordance with the Repayment Letter.
4. **REPRESENTATIONS, WARRANTIES AND COVENANTS.** (1) Borrower represents and warrants to Bank, and covenants and agrees with Bank, that: (i) Borrower has read the statements included in the Application, including the Statements Required by Law and Executive Orders, and Borrower understands them. (ii) Borrower was and remains eligible to receive a loan under the rules and guidance issued by the SBA implementing the Paycheck Protection Program under Division A, Title I of the CARES Act (the "Paycheck Protection Program Rule") in effect at the time Borrower submitted to Bank its Paycheck Protection Program Application Form (the "Application"). (iii) Borrower (a) is an independent contractor, eligible self-employed individual, or sole proprietor or (b) employs no more than the greater of 500 employees or, if applicable, the size standard in number of employees established by the SBA in 13 C.F.R. 121.201 for Borrower's industry. (iv) Borrower will comply whenever applicable, with the civil rights and other limitations in the Application. (v) All proceeds of the Loan will be used only for business-related purposes as specified in the Application and consistent with the Paycheck Protection Program Rule. (vi) To the extent feasible, Borrower will purchase only American-made equipment and products. (vii) Borrower is not engaged in any activity that is illegal under federal, state or local law. (viii) Borrower certifies that any loan received by Borrower under Section 7(b)(2) of the Small Business Act between January 31, 2020 and April 3, 2020 that will remain outstanding after funding of this Loan was for a purpose other than paying payroll costs and other allowable uses of loan proceeds under the Paycheck Protection Program Rule. (ix) Borrower was in operation on February 15, 2020 and had employees for whom Borrower paid salaries and payroll taxes or paid independent contractors (as reported on Form(s) 1099-MISC). (x) The current economic uncertainty makes the request

for the Loan necessary to support the ongoing operations of Borrower (as such representation is further explained in SBA guidance with respect to the Paycheck Protection Program). (xi) All proceeds of the Loan will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments, as specified under the Paycheck Protection Program Rule and Borrower acknowledges that if the funds are knowingly used for unauthorized purposes, the federal government may hold Borrower and/or Borrower's authorized representative legally liable, such as for charges of fraud. (xii) Borrower has provided Bank true, correct and complete information demonstrating that Borrower had employees for whom Borrower paid salaries and payroll taxes on or around February 15, 2020. (xiii) Borrower has provided to Bank all documentation available to Borrower on a reasonable basis verifying the dollar amounts of average monthly payroll costs for the calendar year 2019, which documentation shall include, as applicable, copies of payroll processor records, payroll tax filings and/or Form 1099-MISC. (xiv) Borrower will promptly provide to Bank (a) any additional documentation that Bank requests in order to verify payroll costs and (b) documentation verifying the number of full-time equivalent employees on payroll as well as the dollar amounts of payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities for the applicable "covered period" (as determined in accordance with Section 1106 of the CARES Act) following the Loan, including all such documentation required under the forgiveness application promulgated by the SBA. (xv) Borrower acknowledges that (a) loan forgiveness will be provided by the SBA for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities, and at least 60% of the covered loan amount must be used for payroll costs. (xvi) During the period beginning on February 15, 2020 and ending on December 31, 2020, Borrower has not and will not receive any other loan under the Paycheck Protection Program, except for any increase that was expressly permitted under the Paycheck Protection Program Rule. (xvii) Borrower certifies that the information provided in the Application and the information that Borrower provided in all supporting documents and forms is true and accurate in all material respects. Borrower acknowledges that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law, including under 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to \$250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than \$5,000; and, if submitted to a Federally insured institution, under 18 USC 1014 by imprisonment of not more than thirty years and/or a fine of not more than \$1,000,000. (xviii) Borrower understands, acknowledges and agrees that Bank can share any tax information received from Borrower or any Owner with SBA's authorized representatives, including authorized representatives of the SBA Office of Inspector General, for the purpose of compliance with SBA Loan Program Requirements and all SBA reviews. (xix) Neither Borrower nor any Owner, is presently suspended, debarred, proposed for debarment, declared ineligible, voluntarily excluded from participation in this transaction by any Federal department or agency, or presently involved in any bankruptcy. (xx) Neither Borrower, nor any Owner, nor any business owned or controlled by any of them, ever obtained a direct or guaranteed loan from SBA or any other Federal agency that is currently delinquent or has defaulted in the last 7 years and caused a loss to the government. (xxi) Neither Borrower, nor any Owner, is an owner of any other business or has common management with any other business, except as disclosed to the Bank in connection with the Borrower's Application. (xxii) Borrower did not receive an SBA Economic Injury Disaster Loan between January 31, 2020 and April 3, 2020, except as disclosed to the Bank in connection with the Borrower's Application. (xxiii) Neither Borrower (if an individual), nor any individual owning 20% or more of the equity of Borrower (each, an "Owner"), is subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction, or presently incarcerated, on probation or parole. (xxiv) Neither Borrower (if an individual), nor any Owner, has been incarcerated, on probation, on parole; presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction; or has been convicted of a felony involving fraud, bribery, embezzlement, or a false statement in a loan application or an application for federal financial assistance within the last five years or any other felony within the last year. (xxv) The United States is the principal place of residence for all employees of Borrower included in Borrower's payroll calculation included in the Application. (xxvi) The Borrower correctly indicated on its Application whether it is a franchise that is listed in the SBA's franchise directory. (xxvii) If Borrower is claiming an exemption from all SBA affiliation rules applicable to Paycheck Protection Program loan eligibility under the religious exemption to the affiliation rules, Borrower has made a reasonable, good faith determination that it qualifies for such religious exemption under 13 C.F.R. 121.103(b)(10), which provides that "[t]he relationship of a faith-based organization to another organization is not considered an affiliation with the other organization...if the relationship is based on a religious teaching or belief or otherwise constitutes a part of the exercise of religion." (2) At all times during the term of the Loan, Borrower represents and warrants to the Bank, that (i) if Borrower is anything other than a natural person, it is duly formed and existing under the laws of the state or other jurisdiction where organized; (ii) this Note, and any instrument or agreement required under this Note, are within Borrower's powers, have been duly authorized, and do not conflict with any of its organizational papers; (iii) the information included in the Beneficial Ownership Certification most recently provided to the Bank, if applicable, is true and correct in all respects; and (iv) in each state in which Borrower does business, it is properly licensed, in good standing, and, where required, in compliance with fictitious name (e.g. trade name or d/b/a) statutes. **IF THE FUNDING DATE IS AFTER THE DATE OF THIS NOTE, BORROWER AGREES THAT BORROWER SHALL BE DEEMED TO HAVE REPEATED AND REISSUED, IMMEDIATELY PRIOR TO THE FUNDING ON THE FUNDING DATE, THE REPRESENTATIONS, WARRANTIES, COVENANTS AND AGREEMENTS SET FORTH ABOVE IN THIS PARAGRAPH.**

5. **EVENTS OF DEFAULT:** If all or any portion of the Loan is not forgiven and a Loan Balance remains after the first to occur of the Forgiveness Remittance Date and the Forgiveness Period Outside Date, then from the date the Repayment Letter is sent to Borrower until the Loan Balance is fully paid, the occurrence and continuation of any of the following events shall constitute a default hereunder: (i) insolvency, bankruptcy, dissolution, issuance of an attachment or garnishment against Borrower; (ii) failure to make any payment when due under the Loan or any or all other loans made by Bank to Borrower, and such failure continues for ten (10) days after it first became due; (iii) failure to provide current financial information promptly upon request by Bank; (iv) the making of any false or materially misleading statement on any application or any financial statement for the Loan or for any or all other loans made by Bank to Borrower; (v) Bank in good faith believes the prospect of payment under the Loan or any or all other loans made by Bank to Borrower is impaired; (vi) Borrower under or in connection with the Loan or any or all other loans made by Bank to Borrower fails to timely and properly observe, keep or perform any term, covenant, agreement, or condition herein or therein; (vii) default shall be made with respect to any other indebtedness for borrowed money of Borrower, if the default is a failure to pay at maturity or if the effect of such default is to accelerate the maturity of such indebtedness for borrowed money or to permit the holder or obligee thereof or other party thereto to cause any such indebtedness for borrowed money to become due prior to its stated maturity; (viii) the Bank in its sole discretion determines in good faith that an event has occurred that materially and adversely affects Borrower; (ix) any change shall occur in the ownership of the Borrower; (x) permanent cessation of Borrower's business operations; (xi) Borrower, if an individual, dies, or becomes disabled, and such disability prevents the Borrower from continuing to operate its business; (xii) Bank receives notification or is otherwise made aware that Borrower, or any affiliate of Borrower, is listed as or appears on any lists of known or suspected terrorists or terrorist organizations provided to Bank by the U.S. government under the USA Patriot Act of 2001; and (xiii) Borrower fails to maintain the Deposit Account with the Bank. In addition, a default shall occur immediately hereunder if the SBA demands repayment in full by Borrower of the Loan

prior to the maturity date hereof for any reason, including, without limitation, as a result of an SBA determination that Borrower was ineligible for this Loan for any reason, including as a result of an improper necessity certification, eligibility certification or other certification in the Application for the Loan.

6. **REMEDIES:** Upon the occurrence of a default described in Section 5 above, all or any portion of the entire amount owing on the Loan, and any and all other loans made by Bank to Borrower, shall, at Bank's option, become immediately due and payable without demand or notice. Upon a default, Bank may exercise any other right or remedy available to it at law or in equity. All persons included in the term "Borrower" are jointly and severally liable for repayment, regardless of to whom any advance of credit was made. Borrower shall pay any costs Bank may incur including without limitation reasonable attorney's fees and court costs should the Loan and/or any and all other loans made by Bank to Borrower be referred to an attorney for collection to the extent permitted under applicable state law. EACH PERSON INCLUDED IN THE TERM BORROWER WAIVES ALL SURETYSHIP AND OTHER SIMILAR DEFENSES TO THE FULL EXTENT PERMITTED BY APPLICABLE LAW.
7. **CREDIT INVESTIGATION:** If the Loan is not forgiven and a Loan Balance remains, then from the date the Repayment Letter is sent to Borrower until the Loan Balance is fully paid, Borrower authorizes Bank and any of its affiliates at any time to make whatever credit investigation Bank deems is proper to evaluate Borrower's credit, financial standing and employment and Borrower authorizes Bank to exchange Borrower's credit experience with credit bureaus and other creditors Bank reasonably believes are doing business with Borrower. Borrower also agrees to furnish Bank with any financial statements Bank may request at any time and in such detail as Bank may require.
8. **NOTICES:** Borrower's request for Loan forgiveness, and the documentation that must accompany that request, shall be submitted to Bank by transmitting the communication to the electronic address, website, or other electronic transmission portal provided by Bank to Borrower. Otherwise, all notices required under this Note shall be personally delivered or sent by first class mail, postage prepaid, or by overnight courier, to the addresses on the signature page of this Note, or sent by facsimile to the fax number(s) listed on the signature page, or to such other addresses as the Bank and the Borrower may specify from time to time in writing (any such notice a "Written Notice"). Written Notices shall be effective (i) if mailed, upon the earlier of receipt or five (5) days after deposit in the U.S. mail, first class, postage prepaid, (ii) if telecopied, when transmitted, or (iii) if hand-delivered, by courier or otherwise (including telegram, lettergram or mailgram), when delivered. In lieu of a Written Notice, notices and/or communications from the Bank to the Borrower may, to the extent permitted by law, be delivered electronically (i) by transmitting the communication to the electronic address provided by the Borrower or to such other electronic address as the Borrower may specify from time to time in writing, or (ii) by posting the communication on a website and sending the Borrower a notice to the Borrower's postal address or electronic address telling the Borrower that the communication has been posted, its location, and providing instructions on how to view it (any such notice, an "Electronic Notice"). Electronic Notices shall be effective when presented to the Borrower, or is sent to the Borrower's electronic address or is posted to the Bank's website. To retain a copy for your records, please download and print or save a copy to your device.
9. **CHOICE OF LAW; JURISDICTION; VENUE.** (1) At all times that Bank is the holder of this Note, except to the extent that any law of the United States may apply, this Note shall be governed and interpreted according to the internal laws of the state of Borrower's principal place of business (the "Governing Law State"), without regard to any choice of law, rules or principles to the contrary. However, the charging and calculating of interest on the obligations under this Note shall be governed by, construed and enforced in accordance with the laws of the state of North Carolina and applicable federal law. Nothing in this paragraph shall be construed to limit or otherwise affect any rights or remedies of Bank under federal law. Borrower and Bank agree and consent to be subject to the personal jurisdiction of any state or federal court located in the Governing Law State so that trial shall only be conducted by a court in that state. (2) Notwithstanding the foregoing, when SBA is the holder, this Note will be interpreted and enforced under federal law, including SBA regulations. Lender or SBA may use state or local procedures for filing papers, recording documents, giving notice, foreclosing liens, and other purposes. By using such procedures, SBA does not waive any federal immunity from state or local control, penalty, tax, or liability. As to this Note, Borrower may not claim or assert against SBA any local or state law to deny any obligation, defeat any claim of SBA, or preempt federal law.
10. **MISCELLANEOUS.** The Loan may be sold or assigned by Bank without notice to Borrower. Borrower may not assign the Loan or its rights hereunder to anyone without Bank's prior written consent. If any provision of this Note is contrary to applicable law or is found unenforceable, such provision shall be severed from this Note without invalidating the other provisions thereof. Bank may delay enforcing any of its rights under this Note without losing them, and no failure or delay on the part of Bank in exercising any right, power or privilege hereunder shall operate as a waiver thereof; nor shall any single or partial exercise of any right, power or privilege hereunder preclude any other or future exercise thereof or the exercise of any other right, power or privilege. Bank, by its acceptance hereof, and the making of the Loan and Borrower understand and agree that this Note constitutes the complete understanding between them. This Note shall be binding upon Borrower, and its successors and assigns, and inure to the benefit of Bank and its successors and assigns. This Note automatically may be amended from time to time to comply with any express requirements under any amendment of the CARES Act or any rules or guidance promulgated with respect thereto to the extent applicable to this Note, in each case without the requirement of any consent of or notice to Borrower.
11. **BORROWING AUTHORIZED.** The signer for Borrower represents, covenants and warrants to Bank that he or she is certified to borrow for the Borrower and is signing this Note as the duly authorized sole proprietor, owner, sole shareholder, officer, member, managing member, partner, trustee, principal, agent or representative of Borrower, and further acknowledges and confirms to Bank that by said signature he or she has read and understands all of the terms and provisions contained in this Note and agrees and consents to be bound by them. This Note and any instrument or agreement required herein, are within the Borrower's powers, have been duly authorized, and do not conflict with any of its organizational papers. The individuals signing this Agreement on behalf of each Borrower are authorized to sign such documents on behalf of such entities. For purposes of this Note only, the Bank may rely upon and accept the authority of only one signer on behalf of the Borrower, and for this Note, this resolution supersedes and replaces any prior and existing contrary resolution provided by Borrower to Bank.
12. **ELECTRONIC COMMUNICATIONS AND SIGNATURES.** This Note and any document, amendment, approval, consent, information, notice, certificate, request, statement, disclosure or authorization related to this Note (each a "Communication"), including Communications required to be in writing, may, if agreed by the Bank, be in the form of an Electronic Record and may be executed using Electronic Signatures, including, without limitation, facsimile and/or .pdf. The Borrower agrees that any Electronic Signature (including, without limitation, facsimile or .pdf) on or associated with any Communication shall be valid and binding on the Borrower to the same extent as a manual, original signature, and that any

Communication entered into by Electronic Signature, will constitute the legal, valid and binding obligation of the Borrower enforceable against the Borrower in accordance with the terms thereof to the same extent as if a manually executed original signature was delivered to the Bank. Any Communication may be executed in as many counterparts as necessary or convenient, including both paper and electronic counterparts, but all such counterparts are one and the same Communication. For the avoidance of doubt, the authorization under this paragraph may include, without limitation, use or acceptance by the Bank of a manually signed paper Communication which has been converted into electronic form (such as scanned into PDF format), or an electronically signed Communication converted into another format, for transmission, delivery and/or retention. The Bank may, at its option, create one or more copies of any Communication in the form of an imaged Electronic Record ("Electronic Copy"), which shall be deemed created in the ordinary course of the Bank's business, and destroy the original paper document. All Communications in the form of an Electronic Record, including an Electronic Copy, shall be considered an original for all purposes, and shall have the same legal effect, validity and enforceability as a paper record. Notwithstanding anything contained herein to the contrary, the Bank is under no obligation to accept an Electronic Signature in any form or in any format unless expressly agreed to by the Bank pursuant to procedures approved by it; provided, further, without limiting the foregoing, (a) to the extent the Bank has agreed to accept such Electronic Signature, the Bank shall be entitled to rely on any such Electronic Signature without further verification and (b) upon the request of the Bank any Electronic Signature shall be promptly followed by a manually executed, original counterpart. For purposes hereof, "Electronic Record" and "Electronic Signature" shall have the meanings assigned to them, respectively, by 15 USC §7006, as it may be amended from time to time.

13. **CONVERSION TO PAPER ORIGINAL.** At the Bank's discretion the authoritative electronic copy of this Note ("Authoritative Copy") may be converted to paper and marked as the original by the Bank (the "Paper Original"). Unless and until the Bank creates a Paper Original, the Authoritative Copy of this Agreement: (1) shall at all times reside in a document management system designated by the Bank for the storage of authoritative copies of electronic records, and (2) is held in the ordinary course of business. In the event the Authoritative Copy is converted to a Paper Original, the parties hereto acknowledge and agree that: (1) the electronic signing of this Agreement also constitutes issuance and delivery of the Paper Original, (2) the electronic signature(s) associated with this Agreement, when affixed to the Paper Original, constitutes legally valid and binding signatures on the Paper Original, and (3) the Borrower's obligations will be evidenced by the Paper Original after such conversion.

14. **BORROWER ATTESTATION.** Borrower attests and certifies to Bank that it has not provided false or misleading information or statements to the SBA or the Bank in its application for the Loan, and that the certifications, representations, warranties, and covenants made to the Bank in this Note and elsewhere relating to the Loan are true, accurate, and correct. Borrower further attests and certifies to Bank that it has read, understands, and acknowledges that the Loan is being made under the CARES Act, and any use of the proceeds of the Loan other than as permitted by the CARES Act and related rules and guidance, or any false or misleading information or statements provided to the Bank in its application for the Loan or in this Note may subject the Borrower to criminal and civil liability under applicable state and federal laws and regulations, including but not limited to, the False Claims Act, 31 U.S.C. Section 3729, et. seq. Borrower further acknowledges and understands that this Note is not valid and effective until and unless Borrower's application for the Loan is approved and Bank's receiving confirmation from the SBA that Bank may proceed with the Loan.

IN WITNESS WHEREOF, I, the authorized representative of the Borrower, hereto have caused this Promissory Note to be duly executed as of the date set forth below.

BORROWER: Schmitt Industries Inc



Signature of Authorized Representative of Borrower

Jamie Schmidt

Print Name

Authorized Representative

Title

STREET ADDRESS: 2765 NW Nicolai St

CITY/STATE/ZIP CODE: Portland, OR 97210-1897

Subsidiary

Schmitt Measurement Systems, Inc.
Schmitt Europe, Ltd.
Schmitt Industries Canada, Ltd.

State of Incorporation or
Country in Which Organized

Oregon
United Kingdom
Canada

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statements (Form S-3 No. 333-226581 and Form S-8 No. 333- 03910 and 333-229591) of our report dated August 31, 2020, relating to the consolidated financial statements of Schmitt Industries, Inc. and subsidiaries, appearing in this Annual Report (Form 10-K) for the year ended May 31, 2020.

/s/ Moss Adams LLP

Portland, Oregon
August 31, 2020

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

I, Michael R. Zapata, 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) 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

(d) 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 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 31, 2020

/s/ Michael R. Zapata

Michael R. Zapata, Chairman and Chief Executive Officer

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

I, Jamie Schmidt, 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 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) 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

(d) 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 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 31, 2020

/s/ Jamie Schmidt

Jamie Schmidt, Chief Financial Officer and Treasurer

**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, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Michael R. Zapata, Chairman and Chief Executive Officer and Jamie Schmidt, Chief Financial Officer and Treasurer, 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 results of operations of the Company.

/s/ Michael R. Zapata

Michael R. Zapata
Chairman and Chief Executive Officer
August 31, 2020

/s/ Jamie Schmidt

Jamie Schmidt
Chief Financial Officer and Treasurer
August 31, 2020