

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 [FEE REQUIRED]
For the fiscal year ended: May 31, 1996

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 [NO FEE REQUIRED]
For the transition period from _____ to _____

Commission File Number: 0-23996

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

Oregon 91-1151989
(State or other jurisdiction of (IRS Employer Identification Number)
incorporation or organization)

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

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

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

Title of each class	Name of each exchange on which registered
----- None	----- None

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

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

Indicate by check mark whether the registrant (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the
registrant was required to file such reports), and (2) has been subject to such
filing requirements for the past 90 days.

Yes No
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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.

As of August 20, 1996, the aggregate market value of the registrant's
Common Stock held by nonaffiliates of the registrant was \$20,107,188 based on
the closing sales price of the registrant's Common Stock on the Nasdaq - Small
Cap Market. On that date, there were 6,981,889 shares of Common Stock
outstanding.

Portions of the registrant's 1996 Annual Report to Shareholders are
incorporated by reference into Parts II and IV hereof.

PART I

ITEM 1. BUSINESS

INTRODUCTION

The Company designs, assembles and markets computer-controlled balancing equipment for use primarily by the machine tool industry. Through its wholly owned subsidiary acquired in May 1995, Schmitt Measurements Systems, Inc. ("SMS"), a Montana corporation, the Company also designs, manufactures and markets precision laser measurement systems. In June 1996, the Company formed Schmitt Europe, Ltd. under the laws of Great Britain to market and sell the Company's products in Great Britain.

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

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

During Fiscal 1995, the Company completely wrote down its home security alarm technology from \$400,599. This technology was acquired in 1991. As a result of the Company's decision to concentrate its resources on the balancing equipment market during the last several years and, more recently, the precision measurement equipment market, the technology became obsolete and the Company decided to abandon its home security alarm business.

In May 1995, the Company acquired TMA Technologies Inc. ("TMA"), a designer, assembler and marketer of innovative industrial measurement systems based on laser light scatter technologies. For all of the outstanding shares of TMA, the Company paid \$15,000, assumed approximately \$515,000 of TMA debt and agreed to make royalty payments to TMA's shareholders of 5% on sales of TMA products and future Company products that utilize TMA's technologies, hardware, software and existing patents, subject to a maximum royalty of \$6 million. In June 1995, TMA began operations in Portland and subsequently changed its name to Schmitt Measurement Systems, Inc.

BALANCING PRODUCTS

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

The SBS System is fully automated and consequently the user does not have to pre-balance such devices as grinding wheels. This reduces the setup time of such operations and ensures a smoother and more efficient operation.

The SBS System operates on a principle of mass compensation for wheel imbalance. The balance head contains two movable eccentric weights, each of which is driven by electric motors through a precision gear train. These weights can be repositioned to offset any imbalance in a grinding wheel or other application. Imbalance or vibration is picked up by the sensor. The signal is fed to a controller that filters the signal by revolutions per minute. The controller then drives the two balance head weights in the direction that reduces the amplitude of the vibration signal. When the weights are positioned so the lowest vibration level is reached, the balance cycle is complete.

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

Benefits to the system user include improved quality of finished parts, ease of product adaptation, minimal downtime, complete and ready installation, elimination of need for static balancing, longer life for wheels, dressings, diamonds and spindle bearings, the ability to balance within 0.2 microns and its adaptability to all types of machines.

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

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

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

One successful marketing channel to tool builders is the sale of the SBS System to users who purchase new machines and thereby experience the benefits of the SBS System and then purchase additional units for application to their older machines.

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

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

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

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

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

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

Water balancers do not maintain accuracy during grinding and require constant adjustment due to water leakage. Once the machine stops, for whatever reason, it must be rebalanced. Balancing time is generally anywhere from one to three minutes.

Electromechanical balancers similar to the SBS System are produced by several European companies, located primarily in Switzerland, Germany, Spain and Italy. This type of balancer has deficiencies in electronics which render them less effective in solving essential balancing requirements. It cannot achieve the consistent low balance levels obtained by the SBS System and cannot operate effectively at 500 rpm (low speed) or at 7,500 rpm (high speed). In addition, the balancer has proven inferior brush and cable assemblies which cause down time and high maintenance. None of these companies can compete effectively with the Company in providing mounting adapters for all grinding machines.

The SBS System list price is \$7,500 worldwide. The water balancers from Germany are priced at \$11,000 to \$15,000, and the electromechanical systems are priced at \$8,000 to \$10,000 worldwide.

Market surveys by management indicate that customers perceive values of an automatic balancer to be less than \$8,000; therefore, Company pricing is geared to obtaining a dominant market position and meeting competitive supplier prices. The market strategy is to establish the SBS System as the dominant product with the best quality, reliability and performance and superior economic value.

SCHMITT MEASUREMENT SYSTEMS, INC.

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

TMA was founded in Bozeman, Montana in 1984 as Toomay, Mathis and Associates, to utilize the extensive knowledge and industry familiarity of two retired U.S. Air Force generals, John Toomay and Robert Mathis. TMA first offered consulting services for aerospace companies marketing to the U.S. Department of Defense.

By 1986 and 1987, TMA began providing a scatterometer using light scatter technology, primarily for the U.S. military and other departments. Light scatter technology involves using lasers, optics and detectors to throw a beam of light on a material sample and recording its reflection/transmission. Analysis of light scatter information can determine material characteristics such as surface roughness and defects, without introducing contaminants and causing changes to the tested material.

In response to declining military and aerospace budgets, TMA began development of commercial products in 1990 and 1991. During the next three years, TMA continued to invest heavily in commercial product development, but revenue lagged and large operating losses occurred. Funding came from outside investors, new officers/directors and a loan from the Montana Science Technology Alliance.

Pursuant to the terms of the Acquisition Agreement dated April 21, 1995, the Company repaid past accrued wages to 24 TMA employees of \$155,000, repaid all 161 unsecured creditors a total of \$230,000 and agreed to purchase all of the TMA shares. In connection with the acquisition, the Company established a royalty pool (the "Royalty Pool") in which each TMA shareholder and debt holder was given an interest equal to the amount invested by shareholders or loaned by debt holders including interest payable through March 31, 1995. The Royalty Pool is to be funded at 5% of net sales (defined as gross sales less returns, allowances and sales commissions) of SMS's products and future derivative products developed by the Company, subject to a maximum of \$6 million. As a party of the Royalty Pool agreement, each of the former TMA shareholders and debt holders released TMA and the Company from any claims with regard to the acquisition except their rights to future royalties.

Three debt holders who were owed a total of \$362,094 at May 31, 1995 declined to participate in the Royalty Pool and demanded full payment of their respective amounts due. These debt holders filed an action before the U.S. Bankruptcy Court in Montana to cause repayment through liquidation of the Company. The Company successfully converted this action to a reorganization process.

In April 1996, the Company's Plan of Reorganization (the "Plan") was approved by the U.S. Bankruptcy Court. The Plan requires the three debt holders to accept the terms of the Royalty Pool agreement but further requires the Company to purchase the three debt holders' interests as follows: \$91,068 of the debt is to be purchased on April 29, 1996, \$54,640 on March 29, 1997, \$43,713 on March 29, 1998, \$34,970 on March 29, 1999, and \$139,880 on March 20, 2000.

If the remaining unpaid balance of the Royalty Pool is not purchased by the Company in full by March 29, 1998, the remaining balance due will accrue interest at 8% per annum. The Company has the option of purchasing the remaining unpaid balance of the Royalty Pool on or before March 29, 1999, at a 10% discount of the amount then due.

The Plan also requires the Company to segregate the Royalty Pool payments to the former Chief Executive Officer of TMA in an interest-bearing trust account pending the outcome of actions brought by TMA and the Company against Robert C. Mathis and Marvin H. Ball, together with corresponding countersuits initiated in the U.S. District Court for the District of Montana. The extent of potential liability, if any, related to this matter cannot be estimated at this time.

In May 1995, the Company relocated TMA assets and equipment to its Portland, Oregon facility. Three employees were relocated and three part-time former TMA employees remained in Montana to assist with sales and marketing activities.

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

The Company believes that the patents, patent applications, trademarks and other proprietary technology acquired with TMA can be successfully refocused into industrial markets, including electronics, computer disk manufacturers and flat-panel display manufacturers.

The Company is developing a detailed product review and marketing plan. SMS attended and displayed its products at its first industry trade show in September 1995 to gain valuable customer and market input. Review of SMS technology and products for performance, service and competitive marketability was completed by the end of Fiscal 1996. Over the long term, the Company expects TMA technologies and products to add to sales and profitability of the Company. During Fiscal 1996, sales of SMS products totaled \$2,278,977.

SMS operates three businesses: a light-scatter measurement laboratory, laser-based light-scatter measurement products and other laser alignment products. SMS provides a highly advanced, extremely precise measurement services laboratory to a wide variety of industrial and commercial businesses, using advanced laser, light scatter technology.

The laboratory uses three TMA CASI Scatterometers for measuring surface roughness. The true value of the laboratory is not only its extremely precise measurement capability but also that the item being tested is not altered, touched or destroyed. Thus, the laboratory is widely used by the semiconductor and computer hard disk industries, as well as manufacturers of critical optical components in aerospace and defense systems. Customers of the laboratory have included Aerojet, AT&T Bell Labs, Eastman Kodak, General Electric, IBM, NASA and dozens of other industrial companies, universities and government agencies.

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

infrared laser light as a nondestructive probe to measure surface quality, optical performance, smoothness, appearance, defects and contamination on a wide variety of materials.

The sample is mounted on stages capable of moving bidirectionally and/or in rotation. The incident angle can be set anywhere up to an 85 degree angle from surface normal. The detector sweeps around the sample in the incident plane measuring scattered and specular light. During the scan, the computer controls gain, filter and aperture changes through user-defined parameters. The instrument background is measured separately and can be compared with the sample data.

The CASI Analysis Software simplifies analysis of scatter data. BRDF values are used to calculate total integrated scatter, PSD and RMS roughness. Annotated results print on the HP PaintJet printer as viewgraphs or publication-ready figures.

The laboratory generated about 10% of SMS's revenue during Fiscal 1996. Total revenue for this business is expected to rise modestly in the future while representing a smaller percentage of SMS's business. Use of the laboratory, leading to orders for SMS's laser-based light scatter measurement products by its customers, represents the best marketing channel for SMS's current and future products. Existing products (such as the uScan, the GapMaster and Model 2002) and products being developed in conjunction with the measurement services laboratory are being marketed to a variety of industrial customers.

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

The GapMaster provides the totally automatic solution to measuring gap width and surface mismatch. The portable hand-held instrument captures gap widths up to 0.500 inches and mismatches up to 0.250 inches to an accuracy of +/- .005 inches, accommodating both flat and curved surfaces. The GapMaster eliminates angular alignment problems and resolves complex edges, even when there are variations in surface finish. Results are displayed on the LCD located on the rear of the instrument. A 486/33 Mhz computer is provided which instantaneously compares the results to pre-programmable measurement tolerances and returns a pass/fail indication to the operator. Each measurement setting is time and date stamped for statistical process control.

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

*MuScan is normally written with a Greek letter "mu" follow immediately by the word "Scan."

BUSINESS AND MARKETING STRATEGY

MARKETING. The Company designs, assembles and markets all of its products. Its operations are divided into a number of different areas. The production organization, which is responsible for all assembly, purchasing and production engineering, is directed by the Vice President of Operations. The Product Marketing Division is responsible for the sale of SBS System products. This division is managed by the President/CEO and five Marketing Managers. Four of the Marketing Managers are responsible for domestic sales. The fifth Marketing Manager is responsible for sales in mainland China, Japan and Korea. The President/CEO is responsible for sales in both eastern and western Europe and also oversees the efforts of the five Marketing Managers. The technical services division is responsible for providing technical support to customers and is managed by the Vice President of Operations. In addition, there is a research and development group which is supervised directly by the President/CEO and the Vice President of Operations.

The Company markets and sells the SBS System in a variety of ways. First, the Company uses the conventional channels provided by independent manufacturer's representatives and distributors. There are currently 25 individuals and/or organizations in the United States acting in one of these capacities. Compensation comes from commissions which are paid only upon completion of a sale and payment by the customer. The amount paid to the selling person or entity varies between 10% (for independent sales agents) and 15% (for distributors) of the sales amount.

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

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

In the United States, most products are shipped directly to customers from the Company's distribution center in Portland, Oregon. Where the Company has distributors, the product is shipped to the distributor, who in turn pays the Company directly and then delivers and installs the product with the end user. Western European distribution to customers is handled by shipping the product directly from the Company's Portland headquarters to the end users.

The acquisition of SMS (formerly TMA) has resulted in revision of marketing strategy of both the balancer business and the new measurement products. The Company is evaluating all products acquired through the acquisition of TMA and evaluating existing measurement product and balancing product distributors and agents to determine the most efficient mix.

MANUFACTURING. The Company does not use any unique sources of supply or raw materials in its products for either SBS System balancing products or SMS measurement products. Essential electronic components used are available in large quantities from various suppliers. These electronic components

are assembled into the SBS System and SMS electronic control units to meet the Company's quality and assembly standards. Company-owned software and firmware are coupled with the electronic components to provide the basis of the Company's various electronic control units. The Company believes several sources of supplies exist for all electronic components and assembly work that is used in its electronic control system. The Company's primary outside supplier of electronic assembly is Bell Industries of Portland, Oregon, a custom supplier of assembled electronic products for several Pacific Northwest companies. In the event of supply problems, the Company feels two or three alternatives could be developed within 30 days to supplement or replace Bell Industries.

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

The Company uses in-house skilled assemblers to construct and test vendor-supplied components. Component inventory of finished vendor-supplied parts is held on the 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 has instituted a Quality Control Program to conform to ISO-9001 European Quality Certification. Full ISO-9001 certification of the Company's Quality Control Program is expected by December 1996.

The Company has established an SBS System customer base consisting of over 250 companies. No one customer accounts for more than 5% of the Company's total annual revenues. TMA had established over 200 customers, many of whom are also purchasers of the Company's SBS System balancing products. The major customers of TMA (now SMS) have been retained by the Company. No customer of SMS represents more than 5% of the Company's sales.

PATENTS AND TRADEMARKS

SBS SYSTEM PRODUCTS. The Company manufactures its products under copyright protection in the U.S. for all electronic board designs which are also further protected with encapsulation of the finished product to protect the Company technologies and software. U.S. Patent No. 4951526 was issued to the Company on August 28, 1990 and covers both the new ring balancer and the existing SBS Balance Heads that the Company markets to the grinding industries.

The trademark "SBS" is a registered trademark of the Company and is affixed to all products and literature created in the Company's balance product line.

The Company pays no licenses or royalties on its balancing technologies and has offered no concessions, labor agreements or royalty agreements on its balancing product lines.

SMS PRODUCTS. The trademark "SMS" is a registered trademark of the Company and is affixed to all products and literature created in the Company's measurement product line.

The following tables include information about patents and trademarks issued and patents pending with respect to SMS products.

SMS PATENTS ISSUED

5196906	March 1993	muScan: surface measurement
5416590	May 1995	GapMaster: gap and mismatch
08/349598	April 1996	Pitch, yaw of a single laser beam system and method of measuring angular position

SMS PATENTS PENDING

1356.2.4	September 1995	Methods and apparatus for characterizing a surface
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SMS TRADEMARKS

muScan	August 1992	Surface measurement system
CASI	March 1993	Surface inspection system
Accunet	May 1994	Distance measurement NET
FMS	December 1994	Finished measurement systems
Surf-Map	April 1995	Surface inspection process
SMS	September 1995	Schmitt Measurement System

PRODUCT DEVELOPMENT

During Fiscal 1993, 1994 and 1995, research and development activities of the Company were focused on the enhancement of the existing product lines for balancers and on development work toward the new ring balance product. Since its May 1995 acquisition of TMA, the Company has expended significant efforts evaluating existing and potential new products for the light-scatter precision measurement market.

During Fiscal 1994 and 1995, the Company developed the Ring Balancer, a dynamic balancer shaped as a "ring" that allows the device to be fitted "around" a rotating shaft rather than on the end of a shaft where the current Company products are mounted. This mounting and configuration will allow the Company to apply its ring balancers to virtually any rotating device such as fans, turbines, large motors, centrifuges and other industrial machine tools.

During the last several years, the Company has developed several new major offshoot products of its balancing technologies to widen market opportunities. All costs associated with these developments have been borne directly by the Company's customers, with minimal development costs to the Company. Research and development costs for existing product line enhancements are treated as product improvements and expenses, including costs toward the new Ring Balancer.

During Fiscal 1996, the Company continued to develop new balancing products and expended considerable time and effort in evaluating and developing new laser-based measurement products. During Fiscal 1996, the Company developed and began marketing three new surface measurement light scatter machines: the TMS-2000, TMS-2000-W and TMS-3000.

INTERNATIONAL SALES

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

	NORTH AMERICA -----	EUROPE -----	ASIA -----
Fiscal 1996	\$6,298,170	\$442,470	\$339,488
Fiscal 1995	4,018,498	220,741	175,593
Fiscal 1994	2,343,250	128,750	102,998

EMPLOYEES

As of August 1, 1996, the Company employed 28 individuals on a full-time basis. There were no regular part-time employees. None of the Company's employees is covered by a collective bargaining agreement.

ITEM 2. PROPERTIES

The Company's design and assembly facilities and executive offices are located in a 7,500 square foot building in Portland, Oregon. A 33,000-square foot facility located across the street from the executive offices houses SMS's operations. The Company believes its facilities are adequate to meet its current needs.

ITEM 3. LEGAL PROCEEDINGS

In May 1995, the Company acquired TMA Technologies Inc. ("TMA") which became a wholly owned subsidiary of the Company and was renamed Schmitt Measurement Systems, Inc. ("SMS"). During the third quarter of Fiscal 1996, the Company and SMS filed an action against Robert C. Mathis and Marvin H. Ball, former officers and directors of TMA, in the U.S. District Court for the District of Montana. The lawsuit claims that these individuals violated their fiduciary duties to TMA, Schmitt and participants in a TMA royalty pool and are responsible for a Chapter 7 bankruptcy filing against TMA by three debt holders of TMA.

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

No matters were submitted to a vote of the security holders of the Company during the fourth quarter ended May 31, 1996.

PART II

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

The Company's Common Stock was traded on the Vancouver Stock Exchange (the "VSE") from April 1987 to February 1995 when it was voluntarily delisted. Since January 30, 1995, the Common Stock has been traded on the Nasdaq - Small Cap Market under the symbol "SMITF" through February 16, 1996 and "SMIT" since then.

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

VANCOUVER STOCK EXCHANGE
(Canadian dollars)

YEAR ENDED MAY 31, 1995	HIGH	LOW
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First Quarter	\$ 3.60	\$ 3.00
Second Quarter	\$ 3.75	\$ 3.40
Third Quarter (through February 10, 1995)	\$ 3.75	\$ 3.05

NASDAQ - SMALL CAP MARKET
(U.S. dollars)

YEAR ENDED MAY 31, 1995	HIGH	LOW
-----	-----	-----
Third Quarter (from January 30, 1995)	\$ 2.88	\$ 2.25
Fourth Quarter	\$ 2.88	\$ 2.38
YEAR ENDED MAY 31, 1996	HIGH	LOW
-----	-----	-----
First Quarter	\$ 2.88	\$ 2.13
Second Quarter	\$ 5.13	\$ 2.63
Third Quarter	\$ 5.63	\$ 3.88
Fourth Quarter	\$ 14.75	\$ 5.25

As of August 1, 1996, there were 6,981,889 shares of Common Stock outstanding held by approximately 110 holders of record. The number of holders does not include individual participants in security position listings.

In June 1994, the Company paid its only cash dividend, which amounted to CDN \$0.20 per share. The Company's present policy is to retain earnings to finance the Company's business. Any future dividends will be dependent upon the Company's financial condition, results of operations, current and anticipated cash requirements, acquisition plans and plans for expansion and any other factors that the Company's Board of Directors deems relevant. The Company has no present intention of paying dividends on its Common Stock in the foreseeable future.

ITEM 6. SELECTED FINANCIAL DATA

The information required by this Item is included in the Company's Annual Report to Shareholders for the fiscal year ended May 31, 1996 under the heading "Selected Financial Data" and is incorporated herein by reference.

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

The information required by this Item is included in the Company's Annual Report to Shareholders for the fiscal year ended May 31, 1996 under the heading "Management's Discussion and Analysis" and is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The report of independent auditors, financial statements and other information required by this Item are included in the Company's Annual Report to the Shareholders for the fiscal year ended May 31, 1996 and are incorporated herein by reference.

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

In May 1995, the Company replaced its independent accountant, Bruce Jamieson of Vancouver, British Columbia, with Moss Adams LLP. This decision was made by the Company's Board of Directors and was based on the need for an accounting firm with greater experience in U.S. accounting and SEC reporting requirements.

Mr. Jamieson's reports for the fiscal years ended May 31, 1994 and May 31, 1995 did not contain an adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope or accounting principles. During Fiscal 1994 and 1995, there were no disagreements with Mr. Jamieson on any matter of accounting principles or practices, financial statement disclosure or auditing scope of procedure, which disagreements, if not resolved to the satisfaction of Mr. Jamieson, would have caused him to make reference to the subject matter of the disagreements in connection with his report.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The Company's directors and executive officers are as follows:

NAME	AGE	POSITION
Wayne A. Case	56	Chairman/President/CEO, Director
David W. Case	33	Vice President of Operations
Annie Windsor	53	Chief Financial Officer
Linda M. Case	51	Secretary
Maynard E. Brown	46	Director
David L. Dotlich	49	Director
David M. Hudson	44	Director
Trevor Nelson	34	Director
John A. Rupp	56	Director

WAYNE A. CASE has been Chairman of the Board, President and Chief Executive Officer of the Company since 1986. Mr. Case holds a Bachelor of Science degree in Business and Economics from Linfield College and a Master of Business Administration degree from the University of Portland. In addition to overseeing the day-to-day operations of the Company, he is responsible for international marketing operations. Mr. Case is married to Linda M. Case and is the father of David W. Case.

DAVID W. CASE has been Vice President of Operations of the Company since 1993 and before then was Production Manager. Mr. Case holds a Bachelor of Arts degree in Engineering and Business Administration from the University of Oregon. He has been responsible for many of the design features of the SBS Dynamic Balance System. His duties include manufacturing, engineering and quality assurance. Mr. Case is the son of Wayne A. Case.

ANNIE WINDSOR has been Chief Financial Officer of the Company since 1993 and before then acted as Accounting Manager. Ms. Windsor holds a Bachelor of Arts degree in psychology from Coe College in Cedar Rapids, Iowa, and a Master of Arts degree from Southern Illinois University. Her duties include being Chief Financial Officer and creating and maintaining a computerized inventory management and accounting system covering all aspects of the Company's business.

LINDA M. CASE has been Secretary of the Company since 1994 and before then was Office Manager. Her duties include investor relations, office management, purchasing and inventory management. Ms. Case holds a B.A. degree in sociology and psychology from Linfield College in McMinnville, Oregon. Ms. Case is married to Wayne A. Case.

MAYNARD E. BROWN, a director since 1992, resides in British Columbia, Canada. Since November 1993, Mr. Brown has been the senior partner of Brown McCue of Vancouver, British Columbia, which firm specializes in advising publicly held corporations in securities and related matters. Brown McCue acts as the Company's Canadian counsel. Prior to November 1993, he was a sole practitioner in Vancouver. Mr. Brown has a Bachelor of Law degree from Dalhousie University in Halifax, Canada.

DAVID L. DOTLICH, a director since August 1996, is a member of the faculty of the University of Michigan Business School, where he also serves as Executive Director of the Michigan Human Resource Partnership, and on the graduate faculty of the University of Minnesota. He is a consultant to top management of large corporations, including four Fortune 500 companies, specializing in corporate transformation and senior leadership development. Until 1992, he was Executive Vice President of Groupe Bull, a computer manufacturer headquartered in Paris. Mr. Dotlich received a B.A. degree from the University of Illinois, an M.A. degree from the University of Witwaterstand in Johannesburg, South Africa, and a Ph.D. in organizational psychology and management from the University of Minnesota.

DAVID M. HUDSON, a director since August 1996, is founder and President of Coldstream Holdings, Inc. and Coldstream Capital Management, Inc., a privately held registered investment advisory firm which provides advisory services to individuals, institutions, trusts and endowments and advises clients on a variety of corporate finance matters. Mr. Hudson holds a B.S. degree in mathematics from the University of Oregon where he also pursued post-graduate studies in economics.

TREVOR NELSON, a director since 1989, resides in British Columbia, Canada. Since 1988, Mr. Nelson has been a financial planner for the Stewart Thomas Group in Vancouver, British Columbia. He holds a Bachelor of Commerce degree with an emphasis on accounting management and information systems and is a Chartered Accountant.

JOHN A. RUPP, a director since August 1996, is Vice President of Beauty Management, Inc., which owns and manages beauty salons, and manages his personal investments. Mr. Rupp holds a B.A. in economics from Harvard University.

ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth, for each of the three years in the period ended May 31, 1996, amounts of cash and certain other compensation paid by the Company to Wayne A. Case, President and Chief Executive Officer (the "Named Executive"). No other executive officer was paid salary and bonus in excess of \$100,000 in Fiscal 1996.

SUMMARY COMPENSATION TABLE

ANNUAL COMPENSATION

NAME/TITLE	YEAR	SALARY	BONUS	OTHER ANNUAL COMPENSATION	ALL OTHER COMPENSATION
Wayne A. Case(1) President/CEO	1996	\$125,360	--	\$ --	\$ 7,146
	1995	69,837	--	--	6,981
	1994(2)	61,741	--	183,538	5,950

(1) During Fiscal 1995 and 1996, "Other Annual Compensation" included an allocation for automobile use benefits. During Fiscal 1994, "Other Annual Compensation" included \$966 of automobile use benefits and \$182,572 of net market value of exercised stock options. "All Other Compensation" included SEP/IRA and group insurance benefits, which are standardized and equal for all salaried officers.

(2) Converted from Canadian to U.S. dollars at a conversion rate of U.S. \$1.00 = CDN \$1.381 (May 1994 average).

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

The following table provides information with respect to the Named Executive concerning the exercise of options during the fiscal year ended May 31, 1996 and unexercised options held as of such date. No options were granted to the Named Executive in Fiscal 1996.

NAME	SHARES ACQUIRED ON EXERCISE	VALUE REALIZED	NUMBER OF SHARES UNDERLYING UNEXERCISED OPTIONS AT FY-END		VALUE OF UNEXERCISED IN-THE- MONEY OPTIONS AT FY-END(1)	
			EXERCISABLE	UNEXERCISABLE	EXERCISABLE	UNEXERCISABLE
Wayne A. Case	18,750	\$ 37,500	293,250	--	\$ 10,410,375	--

(1) Amounts reflected are based upon the market value of the Common Stock as of May 31, 1996 (\$13.375) minus the exercise price (\$2.00), multiplied by the number of shares underlying the options.

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION*

EXECUTIVE COMPENSATION PHILOSOPHY

The Compensation Committee of the Board of Directors, which is composed of Maynard E. Brown, Wayne A. Case and Trevor Nelson, was established in August 1996 and met then for the first time. Prior to August 1996, the full Board of Directors performed the functions of the Compensation Committee. The Compensation Committee is responsible for setting and administering the policies and programs that govern compensation for the executive officers of the Company. The Board of Directors' Option Committee ("Option Committee"), composed of Maynard E. Brown and Trevor Nelson, administers the Company's Stock Option Plan (the "Option Plan"). The goal of the Company's executive compensation policy is to ensure that an appropriate relationship exists between compensation and corporate performance, while at the same time attracting, motivating and retaining executive officers and other key employees.

The key components of the Company's compensation program are base salary and potential long-term compensation through stock options. These components are administered with the goal of providing total compensation that is competitive in the marketplace, rewards successful financial performance and aligns executive officers' interests with those of stockholders. The Compensation Committee reviews executive compensation on an annual basis, or more often if necessary, and determines, subject to the Board's approval, base salary for executive officers. The Option Committee makes all decisions with respect to stock option grants.

* The report of the Compensation Committee shall not be deemed incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under either the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (together, the "Acts"), except to the extent that the Company specifically incorporates such report by reference; and further, such report shall not otherwise be deemed filed under the Acts.

EQUITY PARTICIPATION

The Company uses stock options granted under its Option Plan both to reward past performance and to motivate future performance, especially long-term performance. The Compensation Committee believes that through the use of stock options, executive interests are directly tied to enhancing shareholder value.

STOCK OPTIONS

As of August 1, 1996, a total of 814,500 shares of Common Stock were subject to outstanding options granted to employees. Wayne A. Case had options to purchase 293,250 shares at an exercise price of CDN \$2.67 per share, expiring on February 4, 1999. David W. Case had options to purchase 237,500 shares at an exercise price of CDN \$1.96 per share, expiring on January 7, 1999. One other employee had options to purchase 12,500 shares at an exercise price of CDN \$1.96 per share, expiring on January 7, 1999. In addition, as of August 1, 1996, options granted under the Option Plan to purchase a total of 271,250 shares of Common Stock with exercise prices of \$4.375, \$5.50 and \$9.75 per share, expiring on January 12, 2002, March 11, 2003 and May 3, 2006, respectively, were outstanding. These options were held by 28 executive officers and employees. A maximum of 500,000 shares of the Company's Common Stock may be issued under the Option Plan.

The stock options provide value to the recipients only when the market price of the Company's Common Stock increases above the option grant price and only as the shares vest and become exercisable. While option grants under the Option Plan are made by the Option Committee, the Compensation Committee considers these grants in making its cash compensation decisions.

COMPENSATION OF CHIEF EXECUTIVE OFFICER

The Chief Executive Officer's compensation is set using the Compensation Committee's general philosophy as described above. In Fiscal 1996, Wayne A. Case received a base salary of \$125,000. He received no stock option grants in Fiscal 1996.

DEDUCTIBILITY OF EXECUTIVE COMPENSATION

The Compensation Committee has considered the impact of Section 162(m) of the Internal Revenue Code adopted under the Omnibus Budget Reconciliation Act of 1993, which section disallows a deduction for any publicly held corporation for individual compensation exceeding \$1 million in any taxable year for the CEO and the four other most highly compensated executive officers, unless such compensation meets certain exceptions to the general rule. Compensation paid by the Company to each

of its executive officers in 1995 was well below \$1 million, and therefore Section 162(m) did not affect the tax deductions available to the Company. The Committee will continue to monitor the applicability of the section to the Company's compensation programs and will determine at a later date what actions, if any, the Company should take to qualify for available tax deductions.

COMPENSATION COMMITTEE

Maynard E. Brown
Wayne A. Case
Trevor Nelson

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

Since its formation in August 1996, the Compensation Committee has consisted of Maynard E. Brown, Wayne A. Case and Trevor Nelson. Mr. Case is President and Chief Executive Officer of the Company. Prior to August 1996, the Board of Directors did not have a Compensation Committee; consequently, all directors, including Mr. Case, participated in deliberations concerning executive officer compensation. No member of the Compensation Committee or executive officer of the Company has a relationship that would constitute an interlocking relationship with executive officers or directors of another entity.

DIRECTOR COMPENSATION

The Company has no formal plan for compensating its directors for their service in their capacity as directors. Directors are entitled to reimbursement for reasonable travel and other out-of-pocket expenses incurred in connection with attendance at meetings of the Board of Directors. The Board of Directors may award special remuneration to any director undertaking any special services on behalf of the Company other than services ordinarily required of a director. During Fiscal 1996, no director received any compensation for his services as a director, including committee participation and/or special assignments.

PERFORMANCE GRAPH

The following graph compares the yearly percentage change in the Company's cumulative total shareholder return on its common stock with the cumulative total return for the period from May 31, 1991 through May 31, 1996 of (i) the Total Return Index of Nasdaq Stock Market--U.S. and (ii) the Pacific Stock Exchange ("PSE") Technology Index. The PSE Technology Index represents 100 listed and over-the-counter technology stocks from 15 industries. The graph assumes that on May 31, 1991, \$100 was invested in the Common Stock of the Company and in each of the comparative indices. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

[GRAPH]

	05/31/91	05/31/92	05/31/93	05/31/94	05/31/95	05/31/96
SCHMITT INDUSTRIES, INC.	\$ 100	\$ 117	\$ 233	\$ 1,199	\$ 1,079	\$ 6,076
NASDAQ - US	100	117	141	149	177	257
PSE TECHNOLOGY INDEX	100	106	125	144	201	275

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding beneficial ownership of the Company's Common Stock as of August 1, 1996 by (i) each person who is known to the Company to own beneficially more than 5% of the Company's outstanding Common Stock, (ii) each of the Company's directors and executive officers, (iii) the Named Executive and (iv) all current directors and executive officers as a group.

DIRECTORS, NAMED EXECUTIVE AND 5% SHAREHOLDERS	SHARES BENEFICIALLY OWNED(1)	
	NUMBER	PERCENT
Wayne A. Case(2)	2,202,750(3)	30.3%
David W. Case(2)	402,500(4)	5.6%
Maynard E. Brown	--	--
David L. Dotlich	14,500	*
David M. Hudson	87,500(5)	1.3%
Trevor Nelson	--	--
John A. Rupp	227,000	3.3%
All directors and executive officers as a group (nine persons)	2,944,050(6)	39.2%

* Less than 1%.

- (1) A person is deemed to be the beneficial owner of securities that can be acquired by such person within 60 days from the date hereof upon the exercise of options. Each beneficial owner's percentage ownership is determined by assuming that options that are held by such person (but not those held by any other person) and that are exercisable within 60 days from the date hereof have been exercised. Unless otherwise noted, the Company believes that all persons named in the table have sole voting and investment power with respect to all shares of Common Stock beneficially owned by them.
- (2) The address of the shareholder is care of Schmitt Industries, Inc., 2765 N.W. Nicolai Street, Portland, Oregon 97210.
- (3) Includes 1,659,783 shares held as trustee of the Wayne A. Case Family Trust with respect to which Mr. Case has sole voting and investment power and 750 shares held by Linda M. Case, Mr. Case's wife, as trustee for the Linda A. Case Family Trust with respect to which Mrs. Case has sole voting and investment power. Also includes 293,250 shares subject to options that are currently exercisable.
- (4) Includes 237,500 shares subject to options that are currently exercisable.
- (5) Includes 77,500 shares held by a partnership, the general partner of which is Coldstream Capital Management, Inc. of which Mr. Hudson is president and a shareholder.
- (6) Includes 530,750 shares subject to options that are currently exercisable.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Company paid the law firm of Brown McCue, in which Maynard E. Brown, a director of the Company, is a principal, a total of \$20,981 in Fiscal 1995 and \$15,370 in Fiscal 1996 for legal services.

PART IV

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

(a) Documents filed as part of this report:

1. FINANCIAL STATEMENTS:

Annual Report
Page Number

A.	Consolidated Balance Sheets as of May 31, 1996 and May 31, 1995.....	6
B.	Consolidated Statements of Income for each of the years ended May 31, 1996, May 31, 1995 and May 31, 1994.....	7
C.	Consolidated Statements of Cash Flows for each of the years ended May 31, 1996, May 31, 1995 and May 31, 1994.....	8-9
D.	Consolidated Statements of Changes in Stockholders' Equity for each of the years ended May 31, 1996, May 31, 1995 and May 31, 1994.....	9
E.	Notes to Financial Statements.....	10-14
F.	Independent Auditors' Report.....	20

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: See Index to Exhibits on page 24.

(b) Reports on Form 8-K: No reports on Form 8-K were filed by the Company during the fourth quarter ended May 31, 1996.

SIGNATURES

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

SCHMITT INDUSTRIES, INC.

By: /s/ Wayne A. Case

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

Date: August 28, 1996

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 28, 1996.

SIGNATURE	TITLE
/s/ Wayne A. Case ----- Wayne A. Case	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
/s/ Annie Windsor ----- Annie Windsor	Chief Financial Officer (Principal Financial and Accounting Officer)
/s/ Maynard E. Brown ----- Maynard E. Brown	Director
/s/ David M. Hudson ----- David M. Hudson	Director
/s/ Trevor Nelson ----- Trevor Nelson	Director

INDEX TO EXHIBITS

EXHIBITS	DESCRIPTION
3(i)	Restated Articles of Incorporation of Schmitt Industries, Inc. (the "Company"). Incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-4, File No. 33-98226, as amended.
3(ii)	Restated Bylaws of the Company. Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-4, File No. 33-98226, as amended.
*10.1	Schmitt Industries, Inc. Stock Option Plan.
*10.2	Agreement dated April 21, 1995 between TMA Technologies, Inc. and the Company.
*11.1	Schedule of computation of net income per share
*13.1	Annual Report to Shareholders of Schmitt Industries, Inc. for fiscal year ended May 31, 1996.. . . .
*21.1	Subsidiaries of Schmitt Industries, Inc..
*27.1	Financial Data Schedule

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* Filed herewith

SCHMITT INDUSTRIES, INC.

STOCK OPTION PLAN

SCHMITT INDUSTRIES, INC.

STOCK OPTION PLAN

1. PURPOSES. The purposes of this Schmitt Industries, Inc. Stock Option Plan ("Plan") are to:

1.1 retain the services of valued key employees and consultants of Schmitt Industries, Inc. ("Company") and such other persons as the Plan Administrator shall select in accordance with Section 4 below;

1.2 provide such persons with an equity ownership in the Company commensurate with the Company's performance as reflected in increased value of its common shares;

1.3 provide an aid and inducement in hiring of new employees and to provide an equity incentive to directors, consultants and other persons selected by the Plan Administrator; and

1.4 provide a means whereby the Company can continue to attract, motivate and retain the services of selected non-employee agents, consultants, advisors, persons involved in the sale or distribution of the Company's products and independent contractors of the Company.

2. ADMINISTRATION. This Plan shall be administered by the Board of Directors of the Company ("Board") or, in the event the Board shall appoint and/or authorize a committee to administer this Plan, by a committee of the Board consisting of at least two (2) non-employee directors ("Committee"). The administrator of this Plan, whether the Board or Committee, shall hereinafter be referred to as the "Plan Administrator." The Plan Administrator shall administer the Plan in accordance with the following:

2.1 INCAPACITY OF PLAN ADMINISTRATOR. No member of the Board or the Committee shall vote with respect to the granting of an option created under this Plan ("Option(s)") to himself or herself. Any Option granted to a director for his or her services as such shall not be effective until approved by the full Board.

2.2 REGISTRATION UNDER THE SECURITIES ACT. If the Company registers any of its equity securities pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934, as amended ("Exchange Act") and any officers or directors are

eligible to receive Options, the following provisions shall apply to the administration of this Plan with respect to grants made to directors, officers or other Optionees (as hereinafter defined) affected by Section 16(b) of the Exchange Act. The Plan Administrator shall be constituted at all times so as to meet the requirements of Section 16(b) of the Exchange Act, as amended from time to time. The members of any committee serving as Plan Administrator shall be appointed by the Board for such term as the Board may determine. The Board may from time to time remove members from, or add members to, the committee. Vacancies on the committee, however caused, may be filled by the Board. Currently, the Plan Administrator is a committee. If, at any time, an insufficient number of disinterested non-employee directors is available to serve on such committee, interested non-employee directors may serve on the committee; however, during such time, no Options shall be granted to any person if the granting of such Option would not meet the requirements of Section 16(b) of the Exchange Act. For purposes of this Section 2, a disinterested director shall be a member of the Board who meets the definition of "disinterested person" as set forth in the rules and regulations promulgated under Section 16(b) of the Exchange Act, as amended from time to time (the "16(b) Rules"). Currently, a disinterested director for purposes of this Section 2 is a member of the Board who for one (1) year prior to service as an administrator of this Plan has not been (and during service as a Plan Administrator, will not be) granted or awarded equity securities, including options for equity securities pursuant to this Plan or any other plan of the Company or its affiliates, except for certain exclusions described in Rule 16b-3. For purposes of this Section 2, a non-employee director shall be a member of the Board who meets the definition of "non-employee director" as set forth in the 16(b) Rules. Currently, a non-employee director is a member of the Board who (i) is not currently an officer of the Company or a parent or subsidiary of the Company, or otherwise currently employed by the Company or a parent or subsidiary of the Company; (ii) does not receive compensation, either directly or indirectly, from the Company or a parent or subsidiary of the Company, for services rendered as a consultant or in any capacity other than as a director, except for an amount that does not exceed the dollar amount for which disclosure would be required pursuant to Item 404(a) of Regulation S-K promulgated under the Exchange Act ("S-K"); (iii) does not possess an interest in any other transaction for which disclosure would be required pursuant to Item 404(b) of S-K; and (iv) is not engaged in a business relationship for which disclosure would be required pursuant to Item 404(b) of S-K.

2.3 PROCEDURES. The Board may designate one of the members of the Plan Administrator as chairman. The Plan Administrator may hold meetings at such times and places as it shall determine. The acts of a majority of the members of the Plan Administrator present at meetings at which a quorum exists, or acts reduced to or approved in writing by all Plan Administrator members, shall be valid acts of the Plan Administrator.

2.4 RESPONSIBILITIES. Except for the terms and conditions explicitly set forth in this Plan, the Plan Administrator shall have the authority, in its discretion, to determine all matters relating to the Options, including selection of the individuals to be granted Options, the number of shares to be subject to each Option, the exercise price for such Option ("Exercise Price"), and all other terms and conditions of the Options. The interpretation and construction by the Plan Administrator of any terms or provisions of this Plan or any Option, or of any rule or regulation promulgated in connection with this Plan, shall be conclusive and binding on all interested parties, so long as such interpretation and construction with respect to incentive stock options correspond to the requirements of Section 422 of the Internal Revenue Code of 1986, as amended ("Code"), and the regulations issued thereunder, and any amendment or successor sections or regulations.

2.5 SECTION 16(B) COMPLIANCE AND BIFURCATION OF PLAN. If the Company registers any of its equity securities pursuant to Sections 12(b) and 12(g) of the Exchange Act, it is the intention of the Company that this Plan then comply in all respects with Rule 16b-3 under the Exchange Act and, if any Plan provision is later found not to be in compliance with such Section, the provision shall be deemed null and void. In all events, the Plan shall be construed in favor of its meeting the requirements of Rule 16b-3. Notwithstanding anything in the Plan to the contrary, the Board, in its absolute discretion, may bifurcate the Plan so as to restrict, limit or condition the use of any provision of the Plan to participants who are officers and directors subject to Section 16(b) of the Exchange Act without so restricting, limiting or conditioning the Plan with respect to other participants.

3. STOCK SUBJECT TO THIS PLAN. The stock subject to this Plan shall be the Company's common stock ("Common Stock"). The Company shall have authorized and have in reserve for issuance at the time of exercise of any Option a sufficient number of shares of Common Stock to meet the Company's obligation. The maximum number of shares of Common Stock which may be issued under the Plan shall be five hundred thousand (500,000). If any Option expires or is surrendered, exchanged for another Option, cancelled or terminated for any reason without having been exercised in full, the unpurchased shares subject to such Option shall again be available for purposes of this Plan, including for replacement Options which may be granted in exchange for such expired, exchanged, surrendered, cancelled or terminated Options.

4. ELIGIBILITY. An incentive stock option in accordance with Section 422 of the Code ("Incentive Option") may be granted only to an individual who, at the time the option is granted, is an employee of the Company and who the Plan Administrator may from time to time select for participation in this Plan. Members of the Board shall not be eligible for grants of Incentive Options unless they are also employees of the Company. At the discretion of the Plan Administrator, employees, officers, directors of the Company (including non-employee directors), selected non-employee agents, consultants, advisors, persons involved in the sale or distribution of the Company's products and independent contractors of the Company also may receive stock options which are not qualified under Section 422 of the Code ("Nonqualified

Option"). (Qualified and Nonqualified Options are included collectively within the term "Options" as used in this Plan.) Any party to whom an Option is granted shall be referred to as an "Optionee."

5. TERMS AND CONDITIONS OF OPTIONS. Options granted under this Plan shall be evidenced by written agreements which shall contain such terms, conditions, limitations and restrictions as the Plan Administrator shall deem advisable and which are not inconsistent with this Plan. Notwithstanding the foregoing, Option agreements shall include or incorporate by reference the following terms and conditions:

5.1 NUMBER OF SHARES. Each Option agreement shall state the number of shares of stock subject to the Option.

5.2 OPTION PRICE. The Option agreement shall state the Exercise Price per share, and the Plan Administrator shall act in good faith to establish the Exercise Price as follows:

5.2.1 INCENTIVE OPTIONS. Subject to subsection 5.2.3, the Exercise Price of Incentive Options shall be not less than the fair market value per share of the Common Stock at the time the Incentive Option is granted.

5.2.2 INCENTIVE OPTIONS TO GREATER THAN 10% SHAREHOLDERS. With respect to Incentive Options granted to shareholders then holding greater than ten percent (10%) of the then-issued and outstanding shares of voting stock of the Company, the Exercise Price shall be as required by Section 6.

5.2.3 FAIR MARKET VALUE. With respect to Incentive Options, the fair market value per share of the Common Stock shall be determined by the Plan Administrator in good faith at the time the Incentive Option is granted.

5.2.4 SUBSTITUTED OPTIONS. Options granted in substitution for outstanding Options in the Company in connection with the merger, consolidation, continuation acquisition of property or stock of the Company or a subsidiary of the Company or another corporation or any subsidiary of another corporation may be granted with an exercise price equal to the exercise price for the substituted option of the Company or other corporation, subject to any adjustment consistent with the terms of the transaction pursuant to which the substitution is to occur.

5.2.5 NONQUALIFIED OPTIONS. The Exercise Price of Nonqualified Options shall be as is determined by the Plan Administrator in good faith at the time of their issuance.

5.3 TERM, MATURITY AND VESTING. Subject to the restrictions contained in Sections 5.8 and 6, the term of each Incentive Option shall be ten (10) years from

the date it is granted unless a shorter period of time is established by the Plan Administrator, but in no event shall the term of any Incentive Option exceed ten (10) years. The term of each Nonqualified Option shall also be ten (10) years from the date it is granted unless a shorter period of time is established by the Plan Administrator. The Plan Administrator shall specify which Options granted hereunder are Incentive Options and which are Nonqualified Options.

No Option shall be exercisable until it has vested. The vesting schedule for each Option shall be specified by the Plan Administrator at the time of grant; PROVIDED, that if no vesting schedule is specified at the time of grant, the Option shall vest according to the following schedule:

Number of Years Following Date of Grant	Percentage of Total Option Vested
One	25%
Two	50%
Three	75%
Four	100%

The Plan Administrator may specify a vesting schedule for all or any portion of an Option based on the achievement of performance objectives established in advance of the commencement by the Optionee of services related to the achievement of the performance objectives. Performance objectives shall be expressed in terms of one or more of the following: return on equity, return on assets, share price, market share, sales, earnings per share, costs, net earnings, net worth, inventories, cash and cash equivalents, gross margin or the Company's performance relative to its internal business plan. Performance objectives may be in respect of the performance of the Company as a whole (whether on a consolidated or unconsolidated basis), a related corporation, or a subdivision, operating unit, product or product line of either of the foregoing. Performance objectives may be absolute or relative and may be expressed in terms of a progression or a range. An option which is exercisable (in whole or in part) upon the achievement of one or more performance objectives may be exercised only following written notice to the Optionee and the Company by the Plan Administrator that the performance objective has been achieved.

5.4 EXERCISE. Subject to the limitations on exercise described in subsection 5.3 above and any additional holding period required by applicable law, each Option may be exercised in whole or in part; provided, however, that only whole shares will be issued pursuant to the exercise of any Option. During an Optionee's lifetime, any Options granted under this Plan are personal to him or her and are exercisable solely by such Optionee. Options shall be exercised by delivery to the Company of a written notice of the number of shares with respect to which the Option is to be exercised, together with payment of the Exercise Price in accordance with Section 5.5.

5.5 PAYMENT OF EXERCISE PRICE. Payment of the Exercise Price shall be made in full at the time the written notice of exercise of an Option is delivered to the Company, and shall be in cash, bank certified or cashier's check or personal check (unless at the time of exercise the Plan Administrator in a particular case determines not to accept a personal check) for the Common Stock being purchased. The Plan Administrator can determine in its discretion (i) at the time an Incentive Option is granted, or (ii) at any time before exercise of Nonqualified Options that additional forms of payment will be permitted, including installment payments on such terms and over such period as the Plan Administrator may determine. To the extent permitted by the Plan Administrator and applicable laws and regulations (including, but not limited to, federal tax and securities laws and regulations and state corporate law), an option may be exercised by:

5.5.1 DELIVERY OF COMMON STOCK. Delivery of shares of Common Stock held by an Optionee having a fair market value equal to the Exercise Price, such fair market value to be determined in good faith by the Plan Administrator;

5.5.2 DELIVERY OF PROMISSORY NOTE. Delivery of a full-recourse promissory note executed by the Optionee; provided that (i) such note if delivered in connection with an Incentive Option shall, and such note if delivered in connection with a Nonqualified Option may, bear interest at a rate specified by the Plan Administrator, but in no case less than the rate required to avoid imputation of interest (taking into account any exceptions to the imputed interest rules) for federal income tax purposes; (ii) the Plan Administrator shall specify the term and other provisions of such note at the time an Incentive Option is granted or at any time prior to exercise of a Nonqualified Option; (iii) the Plan Administrator may require that the Optionee pledge the Optionee's shares to the Company for the purpose of securing the payment of such note, and may require that the certificate representing such shares be held in escrow to perfect the Company's security interest; (iv) the note provides that ninety (90) days following the Optionee's termination of employment with the Company or a related Corporation, the entire outstanding balance under the note shall become due and payable, if not previously due and payable; and (v) the Plan Administrator in its sole discretion may at any time after granting an Option restrict or rescind the right to pay using a promissory note upon written notification to any Optionee;

5.5.3 DELIVERY OF SALE PROCEEDS. Delivery of a properly executed written exercise notice, together with irrevocable instructions to a broker, all in accordance with the regulations of the Federal Reserve Board, to promptly deliver to the Company the amount of sale or loan proceeds to pay the exercise price and any federal, state or local withholding tax obligations that may arise in connection with the exercise; provided, that the Plan Administrator may at any time determine that this subsection

5.5.3, to the extent the instructions to the broker call for an immediate sale of the shares, shall not be available to any Optionee who is subject to Section 16(b) of the Exchange Act if such transaction would result in a violation of Section 16(b), or if such Optionee is not an employee at the time of exercise; or

5.5.4 DELIVERY OF WITHHOLDING NOTICE. Delivery of a properly executed written exercise notice together with instructions to the Company to withhold upon exercise from the shares that would otherwise be issued that number of shares having a fair market value equal to the Exercise Price.

5.6 WITHHOLDING TAX REQUIREMENT. The Company or any related entity shall have the right to retain and withhold from any payment of cash or Common Stock under this Plan the amount of taxes required by any government to be withheld or otherwise deducted and paid with respect to such payment. At its discretion, the Company may require an Optionee receiving shares of Common Stock to reimburse the Company for any such taxes required to be withheld by the Company, and may withhold any distribution in whole or in part until the Company is so reimbursed. In lieu of such withholding or reimbursement, the Company shall have the right to withhold from any other cash amounts due or to become due from the Company to the Optionee an amount equal to such taxes or to retain and withhold a number of shares having a market value not less than the amount of such taxes required to be withheld by the Company to reimburse the Company for any such taxes and cancel (in whole or in part) any such shares so withheld. If required by Section 16(b) of the Exchange Act, the election to pay withholding taxes by delivery of shares held by any person who at the time of exercise is subject to Section 16(b) of the Exchange Act, shall be made during the quarterly 10-day window period required under Section 16(b) of the Exchange Act for exercises of stock appreciation rights.

5.7 TRANSFERABILITY OF OPTION. Options and the rights and privileges conferred by this Plan shall not be transferred, assigned or pledged in any manner (whether by operation of law or otherwise) other than (i) by will or by the applicable laws of descent and distribution, or (ii) by gift to members of the Optionee's family, including grandparents, parents, spouses, siblings, children, grandchildren and great-grandchildren, or trusts for the benefit of such family members or to charitable organizations, and shall not be subject to execution, attachment or similar process. Any attempt to transfer, assign, pledge or otherwise dispose of any Option or of any right or privilege conferred by this Plan, contrary to the Code or to the provisions of this Plan, or the sale or levy or any attachment or similar process upon the rights and privileges conferred by this Plan shall be null and void. Notwithstanding the foregoing, an Optionee may, during the Optionee's lifetime, designate a person who may exercise the Option after the Optionee's death by giving written notice of such designation to the Plan Administrator. Such designation may be changed from time to time by the

Optionee giving written notice to the Plan Administrator revoking any earlier designation and making a new designation. In the event that no such designation is made, the executor or personal representative of the Optionee's estate shall have any rights then remaining to the Optionee or his estate under this Plan.

5.8 DURATION OF OPTION. Vested Options shall terminate, to the extent not previously exercised, upon the occurrence of the first of the following events: (i) the expiration of the Option, as designated by the Plan Administrator in accordance with section 5.3; (ii) the date of an Optionee's termination of employment with the Company or any related corporation for cause (as determined in the sole discretion of the Plan Administrator); (iii) the expiration of ninety (90) days from the date of an Optionee's termination of employment with the Company or any related corporation for any reason whatsoever other than cause, death or Disability (as defined below) unless, the exercise period is extended by the Plan Administrator until a date not later than the expiration date of the Option; or (iv) the expiration of one year from (A) the date of death of the Optionee or (B) cessation of an Optionee's employment by reason of Disability (as defined below) unless, the exercise period is extended by the Plan Administrator until a date not later than the expiration date of the Option. If an Optionee's employment is terminated by death, any Option held by the Optionee shall be exercisable only by the person or persons to whom such Optionee's rights under such Option shall pass by the Optionee's will or by the laws of descent and distribution of the state or county of the Optionee's domicile at the time of death. For purposes of the Plan, unless otherwise defined in the Agreement, "Disability" shall mean any physical, mental or other health condition which substantially impairs the Optionee's ability to perform his or her assigned duties for one hundred twenty (120) days or more in any two hundred forty (240) day period or that can be expected to result in death. The Plan Administrator shall determine whether an Optionee has incurred a Disability on the basis of medical evidence acceptable to the Plan Administrator. Upon making a determination of Disability, the Plan Administrator shall, for purposes of the Plan, determine the date of an Optionee's termination of employment.

Unless accelerated in accordance with Section 7, unvested Options shall terminate immediately upon termination of employment of the Optionee by the Company for any reason whatsoever, including death or Disability. For purposes of this Plan, transfer of employment between or among the Company and/or any related corporation shall not be deemed to constitute a termination of employment with the Company or any related corporation. For purposes of this subsection with respect to Incentive Stock Options, employment shall be deemed to continue while the Optionee is on military leave, sick leave or other bona fide leave of absence (as determined by the Plan Administrator). The foregoing notwithstanding, employment shall not be deemed to continue beyond the first ninety (90) days of such leave, unless the Optionee's re-employment rights are guaranteed by statute or by contract.

5.9 STATUS OF SHAREHOLDER. Neither the Optionee nor any party to which the Optionee's rights and privileges under the Option may pass shall be, or shall have any of the rights or privileges of, a shareholder of the Company with respect to any of the shares issuable upon the exercise of any Option unless and until such Option has been exercised.

5.10 RIGHT TO TERMINATE EMPLOYMENT. Nothing in this Plan or in any Option shall confer upon any Optionee any right to continue in the employ of the Company or of a related entity, or to interfere in any way with the right of the Company or of any related corporation to terminate, at will, his or her employment or other relationship with the Company at any time.

5.11 MODIFICATION AND AMENDMENT OF OPTION. Subject to the requirements of Code Section 422 with respect to Incentive Options and to the terms, conditions and limitations of this Plan, the Plan Administrator may modify or amend outstanding Options. The modification or amendment of an outstanding Option shall not, without the consent of the Optionee, impair or diminish any of his or her rights or any of the obligations of the Company under such Option. Except as otherwise provided in this Plan, no outstanding Option shall be terminated without the consent of the Optionee. Unless the Optionee agrees otherwise, any changes or adjustments made to outstanding Incentive Options shall be made in such a manner so as not to constitute a "modification" as defined in Code Section 424(h) and so as not to cause any Incentive Option to fail to continue to qualify as an "incentive stock option" as defined in Code Section 422(b).

5.12 LIMITATION ON VALUE FOR INCENTIVE OPTIONS. As to all Incentive Options, to the extent that the aggregate fair market value of the Common Stock with respect to which Incentive Options are exercisable for the first time by the Optionee during any calendar year (under this Plan and all other incentive stock option plans of the Company, a related corporation or a predecessor corporation) exceeds \$100,000, those Options (or the portion of an Option) beyond the \$100,000 threshold shall be treated as Nonqualified Options. If the Internal Revenue Service publicly rules, issues a private ruling to the Company, any Optionee, or any legatee, personal representative or distributee of an Optionee or issues regulations changing or eliminating such annual limit, the dollar limitation in the preceding sentence shall be adjusted correspondingly.

6. GREATER THAN 10% SHAREHOLDERS. In the case of Incentive Options granted to employees who own at the time of their grant ten percent (10%) or more of the then-issued and outstanding voting stock of the Company, the following rules shall apply:

6.1 EXERCISE PRICE AND TERM OF INCENTIVE OPTIONS. If Incentive Options are granted to employees who own more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or any related corporation, the term of such individual's Incentive Options shall not exceed five (5) years and the Exercise Price shall be not less than one hundred ten percent (110%) of the

fair market value of the Common Stock at the time the Incentive Option is granted. This provision shall control notwithstanding any contrary terms contained in an Option agreement or any other document.

6.2 ATTRIBUTION RULE. For purposes of subsection 6.1, in determining stock ownership, an employee shall be deemed to own such shares as are owned by those persons or entities defined in Code Section 424. For purposes of this Section 6, stock owned by an employee shall include all stock actually issued and outstanding immediately before the grant of the Incentive Option to the employee.

7. ADJUSTMENTS UPON CHANGES IN CAPITALIZATION. The aggregate number and class of shares for which Options may be granted under this Plan, the number and class of shares covered by each outstanding Option and the Exercise Price per share thereof (but not the total price), and each such Option, shall all be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock of the Company resulting from a split-up or consolidation of shares or any like capital adjustment, or the payment of any stock dividend.

7.1 EFFECT OF LIQUIDATION, REORGANIZATION OR CHANGE IN CONTROL.

7.1.1 CASH, STOCK OR OTHER PROPERTY FOR STOCK. Except as provided in subsection 7.1.2, upon a merger (other than a merger of the Company in which the holders of Common Stock immediately prior to the merger have the same proportionate ownership of Common Stock in the surviving corporation immediately after the merger), consolidation, acquisition of property or stock, separation, reorganization (other than a mere reincorporation or the creation of a holding company) or liquidation of the Company, as a result of which the shareholders of the Company receive cash, stock or other property in exchange for or in connection with their shares of Common Stock, any Option granted under this Plan shall terminate, but the Optionee shall have the right immediately prior to any such merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation to exercise such Option in whole or in part, to the extent the vesting requirements set forth in the Option agreement have been satisfied, unless stated otherwise in the Optionee's individual Option agreement.

7.1.2 CONVERSION OF OPTIONS ON STOCK-FOR-STOCK EXCHANGE. If the shareholders of the Company receive capital stock of another corporation ("Exchange Stock") in exchange for their shares of Common Stock in any transaction involving a merger (other than a merger of the Company in which the holders of Common Stock immediately prior to the merger have the same proportionate ownership of Common Stock in the surviving corporation immediately after the merger), consolidation, acquisition of property or stock, separation or reorganization (other than a mere reincorporation or the creation of a holding company), all Options granted under this Plan shall be converted into options to purchase shares of

Exchange Stock unless the Company and the Corporation issuing the Exchange Stock, in their sole discretion, determine that any or all such Options shall not be converted into options to purchase shares of Exchange Stock, but instead shall terminate in accordance with the provisions of subsection 7.1.1. The amount and price of converted options shall be determined by adjusting the amount and price of the Options in the same proportion as used for determining the number of shares of Exchange Stock the holders of the Common Stock receive in such merger, consolidation, acquisition of property or stock, separation or reorganization. Unless accelerated by the Board, the exercise limitations set forth in the Option agreement and the Plan shall continue to apply for the Exchange Stock.

7.1.3 CHANGE IN CONTROL. In the event of a "Change in Control," as defined below, of the Company, unless otherwise determined by the Board prior to the occurrence of such Change in Control, any Options or portions of such Options outstanding as of the date such Change in Control is determined to have occurred that are not yet fully vested on such date shall become immediately exercisable in full.

7.1.4 DEFINITION OF "CHANGE IN CONTROL". For purposes of this Plan, a "Change in Control" shall mean (a) the first approval by the Board or by the stockholders of the Company of an Extraordinary Event, (b) a Purchase or (c) a Board Change. For purposes of the Plan, such terms shall have the following meanings:

7.1.4.1 An "Extraordinary Event" shall mean any of the following actions: (i) any consolidation or merger of the Company in which the Company is not the continuing or surviving corporation or pursuant to which shares of Common Stock would be converted into cash, securities or other property, other than a merger of the Company in which the holders of Common Stock immediately prior to the merger have the same proportionate ownership of common stock of the surviving corporation immediately after the merger; (ii) any sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all, or substantially all, the assets of the Company; or, (iii) the adoption of any plan or proposal for liquidation or dissolution of the Company.

7.1.4.2 A "Purchase" shall mean the acquisition by any person (as such term is defined in Section 13(d) of the Exchange Act) of any shares of Common Stock or securities convertible into Common Stock without the prior approval of a majority of the Continuing Directors (as defined below) of the Company, if after making such acquisition such person is the beneficial owner (as

such term is defined in Rule 13d-3 under the Exchange Act) directly or indirectly of Securities of the Company representing twenty percent (20%) or more of the combined voting power of the Company's then outstanding securities (calculated as provided in paragraph (d) of such Rule 13d-3).

7.1.4.3 A "Board Change" shall have occurred if individuals who constitute the Board of the Company at the time of adoption of this Plan (the "Continuing Directors") cease for any reason to constitute at least a majority of the Board, provided that any person becoming a Director subsequent to the date of adoption of this Plan whose nomination for election was approved by a vote of at least a majority of the Continuing Directors (other than a nomination of an individual whose initial assumption of office is in connection with an actual threatened election contest relating to the election of the Directors of the Company, as such terms are used in Rule 14a-11 of Regulation 14A under the Exchange Act) shall be deemed to be a Continuing Director.

7.2 FRACTIONAL SHARES. In the event of any adjustment in the number of shares covered by any Option, any fractional shares resulting from such adjustment shall be disregarded and each such Option shall cover only the number of full shares resulting from such adjustment.

7.3 DETERMINATION OF BOARD TO BE FINAL. All Section 7 adjustments shall be made by the Board, and its determination as to what adjustments shall be made, and the extent of such adjustments, shall be final, binding and conclusive. Unless an Optionee agrees otherwise, any change or adjustment to an Incentive Option shall be made in such a manner so as not to constitute a "modification" as defined in Code Section 424(h) and so as not to cause his or her Incentive Option to fail to continue to qualify as an incentive stock option as defined in Code Section 422(b).

8. SECURITIES REGULATION. Shares shall not be issued with respect to an Option unless the exercise of such Option and the issuance and delivery of such shares pursuant to the exercise of such Option shall comply with all relevant provisions of law, including, without limitation, any applicable state securities laws, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, and the requirements of any stock exchange upon which the shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance, including the availability of an exemption from registration for the issuance and sale of any shares under this Plan. Inability of the Company to obtain from any regulatory body having jurisdiction, the authority deemed by the Company's counsel to be necessary for the lawful issuance and sale of any shares under this Plan or the unavailability of an exemption from registration for the issuance and sale of any shares under this Plan shall relieve the Company of any liability in respect of the non-issuance or sale of such shares as to which such requisite authority shall not have been obtained.

As a condition to the exercise of any Option, the Company may require the Optionee to represent and warrant at the time of any such exercise that the shares are being purchased only for investment and without any present intention to sell or distribute such shares if, in the opinion of counsel for the Company, such a representation is required by any relevant provision of the aforementioned laws. At the option of the Company, a stop-transfer order against any shares of stock may be placed on the official stock books and records of the Company, and a legend indicating that the stock may not be pledged, sold or otherwise transferred unless an opinion of counsel is provided (concurring in by counsel for the Company) stating that such transfer is not in violation of any applicable law or regulation, may be stamped on stock certificates in order to assure exemption from registration. The Plan Administrator may also require such other action or agreement by the Optionees as may from time to time be necessary to comply with the federal and state securities laws. THIS PROVISION SHALL NOT OBLIGATE THE COMPANY TO UNDERTAKE REGISTRATION OF THE OPTIONS OR STOCK HEREUNDER. Should any of the Company's capital stock of the same class as the stock subject to Options be listed on a national securities exchange, all stock issued under this Plan if not previously listed on such exchange shall be authorized by that exchange for listing on such exchange prior to the issuance of such stock.

9. AMENDMENT AND TERMINATION. This Plan may be amended from time to time as follows:

9.1 BOARD ACTION. The Board may at any time suspend, amend or terminate this Plan; provided, that except as set forth in Section 7, the approval of the Company's shareholders is necessary within twelve (12) months before or after the adoption by the Board of any amendment which will:

9.1.1 increase the number of shares which are to be reserved for the issuance of Options;

9.1.2 permit the granting of stock options to a class of persons other than those presently permitted to receive Options; or

9.1.3 require shareholder approval under applicable law, including Section 16(b) of the Exchange Act.

Any amendment made to this Plan which would constitute a "modification" to Incentive Options outstanding on the date of such amendment, shall not be applicable to such outstanding Incentive Options, but shall have prospective effect only, unless the Optionee agrees otherwise.

9.2 AUTOMATIC TERMINATION. Unless sooner terminated by the Board, this Plan shall terminate ten (10) years from the earlier of (i) the date on which this Plan is adopted by the Board or (ii) the date on which this Plan is approved by the shareholders of the Company. No Option may be granted after such termination or during any suspension of this Plan. The amendment or termination of this

Plan shall not, without the consent of the option holder, alter or impair any rights or obligations under any option previously granted under this Plan.

10. EFFECTIVENESS OF THIS PLAN. This Plan shall become effective upon adoption by the Board so long as it is approved by the Company's shareholders any time within twelve (12) months before or after the adoption of this Plan.

THIS AGREEMENT IS SUBJECT TO ARBITRATION UNDER THE
MONTANA UNIFORM ARBITRATION ACT

AGREEMENT

This Agreement ("Agreement") is entered into this date, is by TMA TECHNOLOGIES, INC., a Montana corporation, hereinafter referred to as "Seller," and SCHMITT INDUSTRIES, INC., an Oregon corporation, hereinafter referred to as "Purchaser."

Other parties to this agreement are TMA shareholders, hereinafter referred to as "Shareholders," and TMA debt holders, hereinafter referred to as "Debt Holders." Purchaser agrees that Seller may not force action by Shareholders and Debt Holders.

WHEREAS, Seller presently has outstanding a single class of common stock ("Shares"), of which 4,568,000 Shares have been issued; and

WHEREAS, said Shares are the only issued and outstanding capital stock of Seller; and

WHEREAS, Purchaser desires to purchase from Seller and from Seller's Shareholders, and Seller desires to facilitate sale to Purchaser, all of the shares of the company on the terms and subject to the conditions set forth herein; and

WHEREAS, Purchaser acknowledges that Seller is insolvent, notwithstanding the efforts by Seller's management which Purchaser acknowledges as being in accordance with sound business practices given the financial restraints of the business; and

WHEREAS, Purchaser acknowledges that Seller currently holds an international leadership position in certain technologies relating to surface characterization and industrial alignment; and

WHEREAS, Purchaser desires to purchase Seller's business, to relocate it to Portland Oregon, and to continue to operate the business as an on-going business;

NOW THEREFORE, IT IS AGREED AS FOLLOWS:

SECTION I.. PURCHASE OF SHARES.

A. PURCHASE OF SHARES. Subject to the terms and conditions set forth herein, at the Closing (as defined below) Seller will sell all of its assets and property, subject to all outstanding debts, liabilities and claims, to Purchaser and Purchaser will purchase all of the outstanding Shares from Shareholders that Shareholders will sell to Purchaser, Shares constituting 4,568,889 shares, which if all are sold constitute

all of the issued and outstanding capital stock of Seller as of the Closing, and Purchaser will purchase all outstanding debt from Debt Holders that Debt Holders will sell to Purchaser, debt constituting as of April 18, 1995 of approximately \$2,827,347, which if all are sold constitute all of the outstanding debt of Seller as of the Closing.

B. PURCHASE PRICE. Purchase will pay to each Selling Shareholder and Debt Holder a cash price of .0025 cents per dollar actually invested by that Shareholder in Seller or loaned (includes loan interest through 3/31/95) to Seller and each Shareholder or Debt Holder so selling shall have a transferable interest in a royalty pool (which royalty pool is presently estimated to total approximately \$6,038,000), in accordance with a Certificate of Vesting in Royalty Pool, attached hereto and incorporated herein by reference. The effective start date of the royalty pool shall be June 1, 1995. The royalty pool will be reviewed (unaudited) before it is established by Moss-Adams, from Seller's books and records. During the life of the royalty pool Moss-Adams, of Portland, Oregon, will administer the royalty pool. Audited statements shall be provided at least annually to all members of the royalty pool. Until all royalty pool participants have received a return equal to their originally established dollar value of their interest in the royalty pool, if Purchaser, or its assigns or subsequent purchasers, sell, license, transfer, or convey in any manner any or all of Seller's technologies covered by this agreement, Purchaser will pay the following amounts into the royalty pool: (1) 25% of the consideration received for the right to utilize the technology; and (2) a royalty of 7% of net sales of the products and services incorporating those technologies for the longer of (1) a period of 10 years from the date the rights to the technologies are purchased from Purchaser and the entity purchasing rights to the technologies.

Purchaser may be required to file a petition for relief from Seller's creditors under Chapter 11 of the Bankruptcy Act. Purchaser agrees to reaffirm in any bankruptcy proceeding its obligations in the royalty pool to each Shareholder and Debt Holder participant, so that Purchaser's obligations contained in the royalty pool as to each participant thereof shall not be discharged by the bankruptcy proceeding.

Purchaser agrees to purchase all of the outstanding debts and obligations of Seller, as set forth on Section 1.1, effective at the execution of this agreement unless specifically disaffirmed in writing signed by both parties. These obligations as of April 18, 1995 are approximately:

- \$155,000 in employee payables
- \$205,000 in accounts payable
- \$123,397 SBA guaranteed loan with First Security Bank
- \$38,344 line of credit with First Security Bank

\$1,752,503.39 convertible debenture with Montana Science and Technology Alliance (amount as agreed between Purchaser and MSTA including principal and interest through March 31, 1995). [Purchaser plans to purchase title and interest in this debt by separate agreement.]
\$10,000 promissory note to Quentin Peterson secured against receipt of payment from future account receivable from Komag
\$1,064,844 all remaining convertible debentures and notes payable [Purchaser plans to purchase title and interest in this debt by separate agreement.]
\$3,212,212 - In addition to purchasing Seller's current debt obligations, Purchaser assumes future royalty obligations related to Seller's current Equity. The Equity portion of the royalty pool is estimated to be greater than \$3.2 Million.

The obligations set forth above will be collectively referred herein to as the "Purchase Price".

C. PAYMENT OF PURCHASE PRICE. According to the terms of the Certificate of Vesting in Royalty Pool, the Purchase Price will be paid to Shareholders and Debt Holders as follows: The cash price of .0025 cents per dollar actually invested or loaned (including principal and interest through 3/31/95) upon the receipt of the stock certificate or agreement to sell the loan debt to Purchaser for approximately \$15,000.

Additionally, each Shareholder and Debt Holder shall receive payments as royalty pool participants in accordance with the royalty pool agreement, until the entire interest in the royalty pool has been paid. Royalty pool total is greater than \$6.0 Million.

Employee payables - including wages, applicable payroll taxes, FTO balances, employee benefits payable, Seller reimbursable expenses, and other related payables - will be paid through April 15, 1995 on or before the second day following the date on which Purchaser has purchased a majority of the outstanding shares of Seller. Employee payables will be paid through April 30, 1995 on or before May 5, 1995. Employee payables accruing after April 30, 1995 will be paid through May 15, 1995 on or before May 20, 1995. Employee payables accruing after May 15, 1995 will be paid through May 31, 1995 on or before June 5, 1995. Employee payables accruing after May 31, 1995 will be paid on the same 5th and 20th schedule.

Delinquent accounts payable will be paid on or before April 28, 1995. SBA guaranteed loan with First Security Bank, and the line of credit with First Security Bank will be paid on or before May 26, 1995.

MSTA and other convertible debenture holders and holders of promissory Notes will be purchased by May 25, 1995, to the extent

to which these debt holders have agreed, by separate agreement, to sell their interest to Purchaser.

SECTION II.. REPRESENTATIONS AND WARRANTIES OF SELLER. As a material inducement to Purchaser to enter into this Agreement and purchase the Shares, Seller, jointly and severally, represents and warrants that:

A. ORGANIZATION AND CORPORATE POWER. Seller is a corporation duly incorporated and validly existing under the laws of the state of Montana and Seller is qualified to do business in every jurisdiction in which its ownership of property or conduct of business requires it to qualify. Seller has all requisite corporate power and authority and all material licenses, permits, and authorizations necessary to own and operate its properties and to carry on its business as now conducted. The copies of Seller's charter documents and bylaws which have been furnished to Purchaser reflect all amendments made thereto at any time prior to the date of this Agreement and are correct and complete.

B. CAPITAL STOCK AND RELATED MATTERS. The authorized capital stock of Seller consists of 12,000,000 shares of common stock, 4,568,889 of which are issued and outstanding and are owned, beneficially and of record, by Shareholders and no other stock of Seller is issued and outstanding. All of the outstanding shares of Seller's capital stock are validly issued, fully paid, and nonassessable.

C. SUBSIDIARIES. Seller does not own or hold any rights to acquire any shares of stock or any other security or interest in any other corporation or entity.

D. CONDUCT OF BUSINESS; LIABILITIES. Purchaser acknowledges that Seller is insolvent. Seller is unable, and has been unable, for some time to pay current employees and suppliers that are integral in Seller's business. Purchaser acknowledges that with each passing day that those obligations remain unpaid the probability increases that there will be a continuing adverse effect on business opportunities. Except as set forth in Schedule 2.4, Seller is not in default under, and no condition exists that with notice would constitute a default of Seller under (i) any mortgage, loan agreement, evidence of indebtedness, or other instrument evidencing borrowed money to which Seller is a party or by which Seller or the properties of Seller are bound or (ii) any judgment, order, or injunction of any court, arbitrator, or governmental agency that would reasonably be expected to affect materially and adversely the business, financial condition, or results of operations of Seller taken as a whole.

E. FINANCIAL STATEMENTS. The unaudited balance sheet of Seller as of February 28, 1995, in the form attached to this Agreement as Exhibit 2.5(A) and the income statement for the

month and year-to-date ending February 28, 1995, in the form attached to this Agreement as Exhibit 2.5(B) (collectively the "February 28, 1995 Financial Statements"), fairly presents the financial position of Seller as of February 28, 1995, and has been prepared in accordance with generally accepted accounting principles, consistently applied, and in a manner substantially consistent with prior financial statements of Seller, except for differences resulting from normally occurring audit adjustments, including, but not limited to, income tax and tax accrual adjustments, or as noted in the Financial Statements or the notes thereto. Except as contemplated by or permitted under this Agreement, there are no adjustments that would be required on review of the Financial Statements that would, individually or in the aggregate, have a material negative effect upon Seller's reported financial condition.

F. NO UNDISCLOSED LIABILITIES. Except for (i) liabilities and obligations incurred in the ordinary course of business since February 28, 1995 ("Statement Date"), and (ii) liabilities or obligations described in Schedule 2.6, neither Seller nor any of the property of Seller is subject to any material liability or obligation that was required to be included or adequately reserved against in the Financial Statements or described in the notes thereto and was not so included, reserved against, or described.

G. ABSENCE OF CERTAIN CHANGES. Except as contemplated or permitted by this Agreement or as described in Schedule 2.7, since the Statement Date there has not been:

1. Any damage, destruction, or loss, whether covered by insurance or not materially adversely affecting the properties or business of Seller;
2. Prior to March 30, 1995 Seller agreed to sell some tangible assets for cash other than in the ordinary course of business, which sales have been completed and disclosed. Other than these enumerated transactions Seller has not entered into any agreement to sell or transfer tangible or intangible assets other than in the ordinary course of business, nor entered into any mortgage or pledge or the creation of any security interest, lien, or encumbrance on any such asset, or any lease of property, including equipment, other than tax liens with respect to taxes not yet due and contract rights of customers in inventory;
3. Any declaration, setting aside, or payment of a distribution in respect of or the redemption or other repurchase by Seller of any stock of Seller;
4. Any material transaction not in the ordinary course of business of Seller;

5. The lapse of any material trademark, assumed name, trade name, service mark, copyright, or license or any application with respect to the foregoing;

6. The grant of any increase in the compensation of officers or employees (including any such increase pursuant to any bonus, pension, profit-sharing, or other plan) other than customary increases on a periodic basis or required by agreement or understanding in the ordinary course of business and in accordance with past practice;

7. The discharge or satisfaction of any material lien or encumbrance or the payment of any material liability other than current liabilities in the ordinary course of business;

8. The making of any material loan, advance, or guaranty to or for the benefit of any person except the creation of accounts receivable in the ordinary course of business; or

9. An agreement to do any of the foregoing.

H. TITLE AND RELATED MATTERS. Except as set forth in Schedule 2.8, Seller has good and marketable title to all of its property and other assets included in the Financial Statements (except properties and assets sold or otherwise disposed of subsequent to the Statement Date or otherwise disclosed in Section G (3), in the ordinary course of business or as contemplated in this Agreement), free and clear of all security interests, mortgages, liens, pledges, charges, claims, or encumbrances of any kind or character, except (i) statutory liens for property taxes not yet delinquent or payable subsequent to the date of this Agreement and statutory or common law liens securing the payment or performance of any obligation of Seller, the payment or performance of which is not delinquent, or that is payable without interest or penalty subsequent to the date on which this representation is given, or the validity of which is being contested in good faith by Seller; (ii) the rights of customers of Seller with respect to inventory under orders or contracts entered into by Seller in the ordinary course of business; (iii) claims, easements, liens, and other encumbrances of record pursuant to filings under personal property recording statutes; and (iv) as described in the Unaudited Statements or the notes thereto, or are of public record, which include the financing statement filed by First Security Bank, and Montana Science and Technology.

I. LITIGATION. Except as set forth in Schedule 2.9, there are no material actions, suits, proceedings, orders, investigations, or claims pending or, to the best of Seller's knowledge, overtly threatened against Seller or any property of Seller, at law or in equity, or before or by any governmental department, commission, board, bureau, agency, or instrumentality; Seller is not subject to any arbitration

proceedings under collective bargaining agreements or otherwise or, to the best of Seller's knowledge, any governmental investigations or inquiries; and, to the best knowledge of Seller, including the directors and responsible officers of Seller, there is no basis for any of the foregoing.

J. TAX MATTERS. Except as set forth on Schedule 2.10, (i) Seller has prepared in a substantially correct manner and has filed all federal, state, local, and foreign tax returns and reports heretofore required to be filed by them and have paid all taxes shown as due thereon; and (ii) no taxing authority has asserted any deficiency in the payment of any tax or informed Seller that it intends to assert any such deficiency or to make any audit or other investigation of Seller for the purpose of determining whether such a deficiency should be asserted against Seller.

K. COMPLIANCE WITH LAWS. To the best of Seller knowledge, Seller is, in the conduct of its business, in substantial compliance with all laws, statutes, ordinances, regulations, orders, judgments, or decrees applicable to them, the enforcement of which, if Seller was not in compliance therewith, would have a materially adverse effect on the business of Seller, taken as a whole. Seller has received no notice of any asserted present or past failure by Seller to comply with such laws, statutes, ordinances, regulations, orders, judgments, OR DECREES.

L. NO BROKERS. There are no claims for brokerage commissions, finders' fees, or similar compensation in connection with the sale of stock based on any arrangement or agreement binding upon any of the parties hereto.

M. INSURANCE. Schedule 2.13 contains a list of each insurance policy maintained by Seller with respect to its properties, assets, and businesses, and each such policy is in full force and effect until April 28, 1995. Seller is past due on the current payment due on the policies, but otherwise is not in material default with respect to its obligations under any such policy maintained by it. Seller has not received formal notification of the cancellation of any of the insurance policies listed on Schedule 2.13 or of any material increase in the premiums to be charged for such insurance policies.

N. EMPLOYEES AND LABOR RELATIONS MATTERS. Except as set forth in Schedule 2.14 or as provided in this Agreement:

1. The Seller is aware that all remaining employees of Seller may be terminated by Purchaser on the Closing Date;

2. To the best of Seller's knowledge, Seller has substantially complied in all material respects with all labor and employment laws, including provisions thereof relating to

wages, hours, equal opportunity, collective bargaining, Americans With Disabilities Act, and the payment of social security and other taxes;

3. There is no unfair labor practice charge, complaint, or other action against Seller pending or, to Seller and the Seller best knowledge, threatened before the National Labor Relations Board and Seller is not subject to any order to bargain by the National Labor Relations Board;

4. No questions concerning representation have been raised or, to Seller's best knowledge, are threatened with respect to employees of Seller;

5. No grievance that might have a material adverse effect on Seller and no arbitration proceeding arising out of or under any collective bargaining agreement is pending and, to the best knowledge of Seller and the directors and responsible officers of Seller, no basis exists for any such grievance or arbitration proceeding; and

6. Seller recognizes that three documents exist which govern the behavior of Seller's current and former employees: (1) Employment Agreement, (2) Employee Confidential Nondisclosure Agreement, and (3) Employee Handbook - Dated February 1, 1995. Seller understands that Purchaser intends to force (if necessary) full compliance with the regulations of these documents for the purpose of protecting the future business prospects. Seller will maintain the security of employee records, with special care being given to the security of documents related to these three documents, for the purpose of supporting Purchaser's efforts to insure full compliance.

O. DISCLOSURE. Neither this Agreement nor any of the schedules, attachments, written statements, documents, certificates, or other items prepared or supplied to Purchaser by or on behalf of the Seller with respect to this purchase contain any untrue statement of a material fact or omit a material fact necessary to make each statement contained herein or therein not misleading. No responsible officer or director of Seller has intentionally concealed any fact known by such person to have a material adverse effect upon Seller's existing or expected financial condition, operating results, assets, customer relations, employee relations, or business prospects taken as a whole.

P. POWER OF ATTORNEY. Except as set forth in Schedule 2.16, no material power of attorney or similar authorization given by Seller is presently in effect.

Q. ACCOUNTS RECEIVABLE. All accounts receivable of Seller reflected in the Financial Statements represent bona fide sales actually made in the ordinary course of business.

R. AGREEMENTS AND COMMITMENTS. Schedule 2.18 contains a complete and accurate list of each agreement, contract, instrument, and commitment (including license agreements) to which Seller is a party or whose term is in excess of one year and is not cancelable upon 30 or fewer days' notice without any liability, penalty, or premium, other than a nominal cancellation fee or charge ("Third Party Agreements"). The agreements contained in Schedule 2.18 Purchaser agrees to perform. Except as otherwise set forth in Schedule 2.18.

1. Corporation has no collective bargaining or union contracts agreement in effect or being negotiated;

2. There is no labor strike, dispute, request for representation, slowdown, or stoppage pending or, to Seller's best knowledge, threatened against Seller;

S. PERSONAL PROPERTY. Without material exception, Schedule 2.19 contains lists of all tangible personal property and assets owned or held by Seller and used or useful in the conduct of the business of Seller. Except as set forth in Schedule 2.19, Seller owns and has good title to such properties subject to any security interest, mortgage, pledge, conditional sales agreement, or other lien or encumbrance. Seller has delivered to Purchaser copies of all leases and other agreements relating to property described in Schedule 2.19 (including any and all amendments and other modifications to such leases and other agreements) all of which are valid and binding. Seller is in default under certain of such leases and agreements. Purchaser has negotiated directly with the lessor of the Seller business premises. Except as set forth in Schedule 2.19 and to the best of Seller's knowledge, all material properties listed therein are generally in good operating condition and repair (ordinary wear and tear excepted), are performing satisfactorily, and are available for immediate use in the conduct of the business and operations of Seller. To the best of Seller's knowledge, all such tangible personal property is in compliance in all material respects with all applicable statutes, ordinances, rules, and regulations. The properties listed in Schedule 2.19 include substantially all such properties necessary to conduct the business and operations of Seller as now conducted.

T. REAL PROPERTY. Seller does not own any real property. No interest in real property will pass by this agreement.

U. PATENTS, TRADEMARKS, TRADE NAMES, ETC. Schedule 2.21 contains an accurate and complete list of all patents, trademarks, tradenames, service marks, and copyrights, and all applications therefor, presently owned or held subject to license by Seller and, to Seller's best knowledge, the use thereof by Seller does not materially infringe on any patents, trademarks, or copyrights or any other rights of any person. To

Seller's best knowledge, Seller has not operated and is not operating its business in a manner that infringes the proprietary rights of any other person in any patents, trademarks, trade names, service marks, copyrights, or confidential information. Except as set forth in Schedule 2.21, Seller has not received any written notice of any infringement or unlawful use of such property.

V. ERISA AND RELATED MATTERS. Schedule 2.22 sets forth a description of all "Employee Welfare Benefit Plans" and "Employee Pension Benefit Plans" (as defined in Sections 3(1) and 3(2), respectively, of the Employee Retirement Income Security Act of 1974, as amended ("ERISA")) existing on the date hereof that are or have been maintained or contributed to by Seller. Except as listed on Schedule 2.22, Seller does not maintain any retirement or deferred compensation plan, savings, incentive, stock option or stock purchase plan, unemployment compensation plan, vacation pay, severance pay, bonus or benefit arrangement, insurance or hospitalization program or any other fringe benefit arrangement for any employee, consultant or agent of Seller, whether pursuant to contract, arrangement, custom or informal understanding, which does not constitute an "Employee Benefit Plan" (as defined in Section 3(3) of ERISA), for which Seller may have any ongoing material liability after Closing. Seller does not maintain nor has it ever contributed to any Multiemployer Plan as defined by Section 3(37) of ERISA. Seller does not currently maintain any Employee Pension Benefit Plan subject to Title IV of ERISA. There have been no "prohibited transactions" (as described in Section 406 of ERISA or Section 4975 of the Code) with respect to any Employee Pension Benefit Plan or Employee Welfare Benefit Plan maintained by Seller as to which Seller has been party a party. As to any employee pension benefit plan listed on Schedule 2.22 and subject to Title IV of ERISA, there have been no reportable events (as such term is defined in Section 4043 of ERISA).

SECTION III.. REPRESENTATIONS AND WARRANTIES OF PURCHASER. As a material inducement to Seller to enter into this agreement and as a material inducement to Shareholders to sell their shares and Debt Holders to sell their interest in debt, Purchaser hereby represents and warrants to Seller, Shareholders, and Debt Holders as follows:

A. ORGANIZATION; POWER. Purchaser is a corporation duly incorporated and validly existing under the laws of the state of Oregon, and has all requisite corporate power and authority to enter into this Agreement and perform its obligations hereunder.

B. AUTHORIZATION. The execution, delivery, and performance by Purchaser of this Agreement and all other agreements contemplated hereby to which Purchaser is a party have been duly and validly authorized by all necessary corporate action of Purchaser, and this Agreement and each such other agreement, when executed and delivered by the parties thereto,

will constitute the legal, valid, and binding obligation of Purchaser enforceable against it in accordance with its terms.

C. NO CONFLICT WITH OTHER INSTRUMENTS OR AGREEMENTS. The execution, delivery, and performance by Purchaser of this Agreement and all other agreements contemplated hereby to which Purchaser is a party will not result in a breach or violation of, or constitute a default under, its Articles of Incorporation or Bylaws or any material agreement to which Purchaser is a party or by which Purchaser is bound.

D. GOVERNMENTAL AUTHORITIES. Except as set forth in Schedule 3.4, (i) Purchaser is not required to submit any notice, report, or other filing with any governmental or regulatory authority in connection with the execution and delivery by Purchaser of this Agreement and the consummation of the purchase and (ii) no consent, approval, or authorization of any governmental or regulatory authority is required to be obtained by Purchaser or any affiliate in connection with Purchaser's execution, delivery, and performance of this Agreement and the consummation of this purchase.

E. LITIGATION. There are no actions, suits, proceedings, or governmental investigations or inquiries pending or, to the knowledge of Purchaser, threatened against Purchaser or its properties, assets, operations, or businesses that might delay, prevent, or hinder the consummation of this purchase.

F. INVESTMENT REPRESENTATIONS

1. Purchaser is acquiring the Shares for its own account for purposes of investment and without expectation, desire, or need for resale and not with the view toward distribution, resale, subdivision, or fractionalization of the Shares.

2. During the course of the negotiation of this Agreement, Purchaser has reviewed all information provided to it by Seller and has had the opportunity to ask questions of and receive answers from representatives of Seller concerning Seller, the securities offered and sold hereby, and this purchase, and to obtain certain additional information requested by Purchaser.

3. Purchaser understands that the Shares to be purchased have not been registered under Securities Act of 1933 ("1933 Act"), or under any state securities law.

4. Purchaser understands that the Shares cannot be resold in a transaction to which the 1933 Act and state securities laws apply unless (i) subsequently registered under the 1933 Act and applicable state securities laws or (ii) exemptions from such registrations are available. Purchaser is aware of the provisions of Rule 144 promulgated under the 1933

Act which permit limited resale of shares purchased in a private transaction subject to the satisfaction of certain conditions.

5. Purchaser understands that no public market now exists for the Shares and that it is uncertain that a public market will ever exist for the Shares.

6. Purchaser understands that the certificates for the Shares will bear the following legend:

THIS CERTIFICATE HAS NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933. THE CORPORATION WILL NOT TRANSFER THIS CERTIFICATE UNLESS (i) THERE IS AN EFFECTIVE REGISTRATION COVERING THE SHARES REPRESENTED BY THIS CERTIFICATE UNDER THE SECURITIES ACT OF 1933 AND ALL APPLICABLE STATE SECURITIES LAWS, (ii) IT FIRST RECEIVES A LETTER FROM AN ATTORNEY, ACCEPTABLE TO THE BOARD OF DIRECTORS OR ITS AGENTS, STATING THAT IN THE OPINION OF THE ATTORNEY THE PROPOSED TRANSFER IS EXEMPT FROM REGISTRATION UNDER THE SECURITIES ACT OF 1933 AND UNDER ALL APPLICABLE STATE SECURITIES LAWS, OR (iii) THE TRANSFER IS MADE PURSUANT TO RULE 144 UNDER THE SECURITIES ACT OF 1933.

3.6.7 Purchaser has reviewed the books and records of Seller regarding transfer of shares. Seller has made no representations or warranties regarding the transfer of those shares or compliance with state or federal securities regulations. Purchaser is purchasing the shares based upon its own investigation and not upon any warranties, expressed or implied, by Seller or any of Seller's directors, officers, employees, or agents.

G. BROKERAGE. There are no claims for brokerage commissions, finders' fees, or similar compensation in connection with this purchase based on any arrangement or agreement entered into by Purchaser and binding upon any of the parties hereto.

H. OPERATION. Purchaser will not relocate any of the furniture, fixtures, equipment, inventory, records, or other assets or property of Seller until the payments set forth in paragraph I.C. Payment of Purchase Price, have been discharged, except payments to royalty pool participants in accordance with the royalty pool agreement. Thereafter, Purchaser may move the assets, technology, and equipment of Seller to its facility at Portland, Oregon. Purchaser will operate the business in such a manner as to maximize the sale of products and services from Seller technology until Purchaser obligations under the royalty pool agreement have been fully discharged. Purchaser agrees to adequately capitalize facilities, equipment, and personnel necessary to maintain Seller technology leadership.

SECTION IV.. CONDUCT OF SELLER'S BUSINESS PENDING THE CLOSING. From the date hereof until the Closing, to the extent to which Purchaser provides adequate funding, and except as

otherwise consented to or approved by Purchaser and Seller, Seller covenants and agrees with Purchaser as follows:

A. **REGULAR COURSE OF BUSINESS.** Purchaser and Seller will jointly provide operating management, operating the business in accordance with the reasonable judgment diligently and in good faith and to preserve its present relationships with persons having business dealings with it.

B. **DISTRIBUTIONS.** Seller will not declare, pay, or set aside for payment any dividend or other distribution in respect of its capital stock.

C. **CAPITAL CHANGES.** Except in facilitating sales of shares by Shareholders to Purchaser, Seller will not issue any shares of its stock, or issue or sell any securities convertible into, or exchangeable for, or options, warrants to purchase, or rights to subscribe to, any shares of its stock or subdivide or in any way reclassify any shares of its capital stock, or repurchase reacquire, cancel, or redeem any such shares.

D. **ASSETS.** The assets, property, and rights now owned by Seller will be used, preserved, and maintained, as far as practicable, in the ordinary course of business, to the same extent and in the same condition as said assets, property, and rights are on the date of this Agreement, and no unusual or novel methods of manufacture, purchase, sale, management, or operation of said properties or business or accumulation or valuation of inventory will be made or instituted. Without the prior consent of Purchaser, Seller will not encumber any of its assets or make any commitments relating to such assets, property, or business, except in the ordinary course of its business.

E. **INSURANCE.** Seller will keep or cause to be kept in effect the insurance now in effect on its various properties and assets, and will purchase such additional insurance, at Purchaser's cost, as Purchaser may request.

F. **EMPLOYEES.** Seller will not grant to any employee any promotion, any increase in compensation, or any bonus or other award.

G. **NO VIOLATIONS.** Seller will comply in all material respects with all statutes, laws, ordinances, rules, and regulations applicable to it in the ordinary course of business.

H. **PUBLIC ANNOUNCEMENTS.** No press release or other announcement to the employees, customers, or suppliers of Seller related to this Agreement or this purchase will be issued without the joint approval of the parties, unless required by law, in which case Purchaser and Seller will consult with each other regarding the announcement.

SECTION V.. COVENANTS OF SELLER. Seller covenants and agrees with Purchaser as follows:

A. SATISFACTION OF CONDITIONS. Seller will use reasonable efforts to obtain as promptly as practicable the satisfaction of the conditions to Closing set forth in Section 7 and any necessary consents or waivers under or amendments to agreements by which Seller is bound.

B. SUPPLEMENTS TO SCHEDULES. As needed prior to the Closing, Seller will promptly supplement or amend the Schedules with respect to any matter hereafter arising that, if existing or occurring at the date of this Agreement, would have been required to be set forth or described in any Schedule and will promptly notify Purchaser of any breach by either of them that either of them discovers of any representation, warranty, or covenant contained in this Agreement. No supplement or amendment of any Schedule made pursuant to this section will be deemed to cure any breach of any representation of or warranty made in this Agreement unless Purchaser specifically agrees thereto in writing; provided, however, that if this purchase is closed, Purchaser will be deemed to have waived its rights with respect to any breach of a representation, warranty, or covenant or any supplement to any Schedule of which it shall have been notified pursuant to this Section 5.2.

C. NO SOLICITATION. Until the Closing or termination pursuant to Section 10 of this Agreement, neither Seller, nor any of Seller's respective directors, officers, employees, or agents shall, directly or indirectly, encourage, solicit, initiate, or enter into any discussions or negotiations concerning any disposition of any of the capital stock or all or substantially all of the assets of Seller (other than pursuant to this Agreement), or any proposal therefor, or furnish or cause to be furnished any information concerning Seller to any party in connection with any transaction involving the acquisition of the capital stock or assets of Seller by any person other than Purchaser. Seller will promptly inform Purchaser of any inquiry (including the terms thereof and the person making such inquiry) received by any responsible officer or director of Seller after the date hereof and believed by such person to be a bona fide, serious inquiry relating to any such proposal.

D. ACTION AFTER THE CLOSING. Upon the reasonable request of any party hereto after the Closing, any other party will take all action and will execute all documents and instruments necessary or desirable to consummate and give effect to this purchase. These include, by way of illustration and not by way of limitation, the following:

1. Various conditions relating to filing, payment, and collecting of refunds relating to taxes;

2. Resignations of each of the directors of Seller.

However, it is now agreed by Seller that when controlling ownership of Seller's shares passes to Schmitt Industries (half of the outstanding shares plus one share), each of Seller's Directors and Officers will submit his resignation. These resignations shall be in writing and shall be effective on the Closing Date. Until the later of the Closing Date or May 31, 1995 Dan Hershberger and Cheryl Petersen shall remain employed by Seller, their costs and expenses during this time being specifically recognized as part of legitimate employee payables. Bob Mathis and Marvin Ball shall be continually informed by Purchaser so as to be aware of Purchaser's decisions and intended actions relative to Seller's assets and interests.;

3. Provisions relating to delivery of Corporate books and records;

4. Provisions relating to treatment of confidential proprietary information obtained in the acquisition process;

SECTION VI.. COVENANT OF PURCHASER. Purchaser will use its best efforts to cause the conditions set forth in Section 8 to be satisfied.

SECTION VII.. CONDITIONS PRECEDENT TO THE OBLIGATIONS OF PURCHASER. Each and every obligation of Purchaser under this Agreement is subject to the satisfaction, at or before the Closing, of each of the following conditions:

A. REPRESENTATIONS AND WARRANTIES; PERFORMANCE. Each of the representations and warranties made by Seller herein will be true and correct in all material respects as of the Closing with the same effect as though made at that time except for changes contemplated, permitted, or required by this Agreement; Seller will have performed and complied with all agreements, covenants, and conditions required by this Agreement to be performed and complied with by them prior to the Closing; and Purchaser will have received, at the Closing, a certificate of Seller's, signed by the Chief Executive Officer of Seller, stating that each of the representations and warranties made by Seller herein is true and correct in all material respects as of the Closing except for changes contemplated, permitted, or required by this Agreement and that Seller has performed and complied with all agreements, covenants, and conditions required by this Agreement to be performed and complied with by them prior to the Closing.

B. NO PROCEEDING OR LITIGATION. No material action, suit, or proceeding before any court, governmental or regulatory authority will have been commenced and be continuing, and no investigation by any governmental or regulatory authority will have been commenced and be continuing, and no action, investigation, suit, or proceeding will be threatened at the time of Closing, against Seller or any of Seller's affiliates, associates, officers, or directors, seeking to restrain, prevent, or change this purchase, questioning the validity or legality of this purchase, or seeking damages in connection with this purchase.

C. MATERIAL CHANGE. From the date of this Agreement to the Closing, Seller shall not have suffered any material adverse change (whether or not such change is referred to or described in any supplement to any Exhibit or Schedule to this Agreement) in its business prospects, financial condition, working capital, assets, liabilities (absolute, accrued, contingent, or otherwise), or operations.

D. CORPORATE ACTION. Seller will have furnished to Purchaser:

1. The corporate articles and all amendments thereto and restatements thereof of Seller in the jurisdiction of incorporation of Seller in question;

2. The current bylaws and minutes of all meetings and consents of shareholders and directors of Seller;

3. Each certificate of qualification to do business as a foreign corporation of Seller;

4. All stock transaction records of Seller; and

5. A certificate of the Assistant Secretary of Seller as to the accuracy, currency, and completeness of each of the above documents, the incumbency and signatures of officers of Seller, the absence of any amendment to the charter documents of Seller, and the absence of any proceeding for dissolution or liquidation of Seller.

SECTION VIII.. CONDITIONS PRECEDENT TO THE OBLIGATIONS OF SELLER. Each and every obligation of Seller under this Agreement is subject to the satisfaction, at or before the Closing, of each of the following conditions:

A. REPRESENTATIONS AND WARRANTIES: PERFORMANCE. Each of the representations and warranties made by Purchaser herein will be true and correct in all material respects as of the Closing with the same effect as though made at that time except for changes contemplated, permitted, or required by this Agreement; Purchaser will have performed and complied with all agreements, covenants, and conditions required by this Agreement

to be performed and complied with by it prior to the Closing; and Seller will have received, at the Closing, a certificate of Purchaser, signed by the President and the Chief Financial Officer of Purchaser, stating that each of the representations and warranties made by Purchaser herein is true and correct in all material respects as of the Closing except for changes contemplated, permitted, or required by this Agreement and that Purchaser has performed and complied with all agreements, covenants, and conditions required by this Agreement to be performed and complied with by it prior to the Closing.

B. NO PROCEEDING OR LITIGATION. No action, suit, or proceeding before any court and any governmental or regulatory authority will have been commenced and be continuing, and no investigation by any governmental or regulatory authority will have been commenced and be continuing, and no action, investigation, suit, or proceeding will be threatened at the time of Closing, against Purchaser or any of Purchaser's affiliates, associates, officers, or directors, seeking to restrain, prevent, or change this purchase, questioning the validity or legality of this purchase, or seeking damages in connection with this purchase.

C. CORPORATE ACTION. Purchaser will have furnished to Seller a copy, certified by the Secretary of Purchaser, of the resolutions of Purchaser authorizing the execution, delivery, and performance of this Agreement.

SECTION IX.. CLOSING.

A. TIME, PLACE AND MANNER OF CLOSING. Unless this Agreement has been terminated and this purchase has been abandoned pursuant to the provisions of Section 10, the closing ("Closing") will be held at the offices of Seller, or such other place as the parties may agree, on May 26, 1995, or as soon as practicable after the satisfaction of the various conditions precedent to the Closing set forth herein. At the Closing the parties to this Agreement will exchange records of transaction of share certificates, Notes, Guaranties, and other instruments and documents in order to determine whether the terms and conditions of this Agreement have been satisfied. Upon the determination of each party that its conditions to consummate this purchase have been satisfied or waived, Seller shall deliver to Purchaser the records of transaction of share certificate(s) evidencing the Shares, and Purchaser shall deliver to Seller evidence that Purchaser has discharged the obligations contained in paragraph I.C. Payment of Purchase Price.

B. CONSUMMATION OF CLOSING. All acts, deliveries, and confirmations comprising the Closing regardless of chronological sequence shall be deemed to occur contemporaneously and simultaneously upon the occurrence of the last act, delivery, or confirmation of the Closing and none of such acts, deliveries, or confirmations shall be effective unless and until the last of

the same shall have occurred. The time of the Closing has been scheduled to correspond with the close of business at the principal office of Seller and, regardless of when the last act, delivery, or confirmation of the Closing shall take place at the principal office of Seller on the date of the Closing, but no later than May 30, 1995.

SECTION X.. TERMINATION.

A. TERMINATION FOR CAUSE. If, pursuant to the provisions of Section 7 or 8 of this Agreement, Seller or Purchaser is not obligated at the Closing to consummate this Agreement, then the party who is not so obligated may terminate this Agreement. If this agreement is terminated Purchaser will retransfer all shares it has purchased in exchange for return of the consideration paid for the share, to Seller who shall reissue new share certificates to Shareholders. If Seller is in compliance with the terms of this agreement and Purchaser elected to terminated this agreement Seller shall not be obligated to reimburse Purchaser for any expenses it has incurred by reason of this agreement. If Purchaser is in compliance with the terms of this agreement and Seller elected to terminated this agreement Seller shall be required to reimburse Purchaser for monies paid by Purchaser under paragraph I.C.

B. TERMINATION WITHOUT CAUSE. Anything herein or elsewhere to the contrary notwithstanding, this Agreement may be terminated and abandoned at any time without further obligation or liability on the part of any party in favor of any other (1) by mutual consent of Purchaser and Seller or (2) if Closing is not consummated by the end of business on May 30, 1995, by no fault of the Seller.

C. TERMINATION PROCEDURE. Any party having the right to terminate this Agreement due to a failure of a condition precedent contained in Sections 7 or 8 hereto may terminate this Agreement by delivering to the other party written notice of termination.

SECTION XI.. MISCELLANEOUS PROVISIONS.

A. AMENDMENT AND MODIFICATION. Subject to applicable law, this Agreement may be amended, modified, or supplemented only by a written agreement signed by Purchaser and Seller.

B. WAIVER OF COMPLIANCE; CONSENTS

1. Any failure of any party to comply with any obligation, covenant, agreement, or condition herein may be waived by the party entitled to the performance of such obligation, covenant, or agreement or who has the benefit of such condition, but such waiver or failure to insist upon strict compliance with such obligation, covenant, agreement, or

condition will not operate as a waiver of, or estoppel with respect to, any subsequent act or other failure.

2. Whenever this Agreement requires or permits consent by or on behalf of any party hereto, such consent will be given in a manner consistent with the requirements for a waiver of compliance as set forth above.

C. NOTICES. All notices, requests, demands, and other communications required or permitted hereunder will be in writing and will be deemed to have been duly given when delivered by hand or three days after being mailed by certified or registered mail, return receipt requested, with postage prepaid:

Purchaser: Schmitt Industries, Inc.
2765 NW Nicolai
Portland, OR 97210

Seller: TMA Technologies, Inc.
601 Haggerty Lane
Bozeman, Montana 59715

D. TITLES AND CAPTIONS. All section titles or captions contained in this Agreement are for convenience only and shall not be deemed part of the context nor effect the interpretation of this Agreement.

E. ENTIRE AGREEMENT. This Agreement contains the entire understanding between and among the parties and supersedes any prior understandings and agreements among them respecting the subject matter of this Agreement.

F. AGREEMENT BINDING. This Agreement shall be binding upon the heirs, personal representatives, executors, administrators, successors and assigns of the parties hereto.

G. ATTORNEY FEES. In the event an arbitration, suit or action is brought by any party under this Agreement to enforce any of its terms, or in any appeal therefrom, it is agreed that the prevailing party shall be entitled to reasonable attorneys fees to be fixed by the arbitrator, trial court, and/or appellate court.

H. COMPUTATION OF TIME. In computing any period of time pursuant to this Agreement, the day of the act, event or default from which the designated period of time begins to run shall be included, unless it is a Saturday, Sunday, or a legal holiday, in which event the period shall begin to run on the next day which is not a Saturday, Sunday, or legal holiday, in which event the period shall run until the end of the next day thereafter which is not a Saturday, Sunday, or legal holiday.

I. PRONOUNS AND PLURALS. All pronouns and any variations thereof shall be deemed to refer to the masculine,

feminine, neuter, singular, or plural as the identity of the person or persons may require.

J. GOVERNING LAW. This Agreement shall be governed by and construed in accordance with the laws of the State of Montana. The parties stipulate that the proper venue for any action commenced as a result of this agreement is Gallatin County, Montana.

K. ARBITRATION. If at any time during the term of this Agreement any dispute, difference, or disagreement shall arise upon or in respect of the Agreement, and the meaning and construction hereof, every such dispute, difference, and disagreement shall be referred to a single arbiter agreed upon by the parties, or if no single arbiter can be agreed upon, an arbiter or arbiters shall be selected in accordance with the rules of the American Arbitration Association and such dispute, difference, or disagreement shall be settled by arbitration in accordance with the then prevailing commercial rules of the American Arbitration Association, and judgment upon the award rendered by the arbiter may be entered in any court having jurisdiction thereof.

L. PRESUMPTION. This Agreement or any section thereof shall not be construed against any party due to the fact that said Agreement or any section thereof was drafted by said party.

M. FURTHER ACTION. The parties hereto shall execute and deliver all documents, provide all information and take or forbear from all such action as may be necessary or appropriate to achieve the purposes of the Agreement.

N. PARTIES IN INTEREST. Nothing herein shall be construed to be to the benefit of any third party except for Shareholders and Debt Holders, nor is it intended that any provision shall be for the benefit of any third party except for Shareholders and Debt Holders.

O. SAVINGS CLAUSE. If any provision of this Agreement, or the application of such provision to any person or circumstance, shall be held invalid, the remainder of this Agreement, or the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

P. INDEMNITY. Seller agrees hold Purchaser harmless against all actions occurring prior to closing and Purchaser agrees to hold harmless Seller, its officers, directors, representatives, attorneys, accountants, or employees for any and all acts occurring prior to closing.

Notes - relative to preliminary signing of this Agreement:

* This agreement is signed with the agreement and understanding of those signing, that this Agreement is subject to the following:

Completion of the Schedules and other information required by this Agreement to be attached.

* Upon initial signature of this Agreement on April 19, 1995, even though the Agreement is subject to the action listed above, Purchaser has loaned \$200,000 to Seller for immediate payment of Seller's delinquent employee payables, certain critical accounts payable.

Seller specifically agrees to disperse these funds only in accordance with Purchaser's direction.

Dated: April 21, 1995

SCHMITT INDUSTRIES, INC.,
an Oregon corporation

TMA TECHNOLOGIES, INC., a
Montana corporation

By: /s/ Wayne A. Case

By: /s/ Marvin H. Ball

Its: President - CEO

Its: CEO

LISTING OF ATTACHMENTS

- - Certificate of Vesting in Royalty Pool {Reference Section I.B.}
Purchaser's separate agreement with Shareholders and Debt Holders.
- - Schedule 1.1 Seller's Debts and Obligations {Reference Section I.B.}
All of the outstanding debts and obligations of Seller, which Purchaser -
by acting upon this Agreement - will purchase .
- - Copies of Seller's Charter and Bylaws {Reference Section II.A.}
Current copies of Seller's charter documents and bylaws, including all
amendments.
- - Schedule 2.1 [Agreement does not specify this Schedule]
- - Schedule 2.2 [Agreement does not specify this Schedule]
- - Schedule 2.3 [Agreement does not specify this Schedule]
- - Schedule 2.4 Seller in Default {Reference Section II.D.}
Listing of conditions in which Seller is currently in default, or in which
Seller would be in default with notice.
- - Exhibit 2.5(A) and Exhibit 2.5(B) Seller's Financial Statements
{Reference Section II.E.}
Seller's Financial Statements with Notes, including the unaudited balance
sheet of Seller as of February 28, 1995 [Exhibit 2.5(A)], and the income
statement for the month and year-to-date ending February 28, 1995
[Exhibit 2.5(B)].
- - Schedule 2.6 Seller's Liabilities {Reference Section II.F.}
Listing of Seller's material liabilities or obligations, not elsewhere
disclosed, i.e. which are not included, adequately reserved against, or
described in the Financial Statements or the notes thereto.
- - Schedule 2.7 Changes by Seller {Reference Section II.G.}
Listing of Seller's following actions, or Seller's agreement to the
following actions, or Seller's knowledge of the conditions described,
except as contemplated or permitted by this Agreement: significant damage
to Seller's property; agreement to sell assets; encumbrance of assets;
redemption of repurchase of stock; any material transaction not in the
ordinary course of business; lapse of trademarks, copyrights

Listing of Attachments - (continued) -

etc.; grant of any increase in compensation; discharge or satisfaction of any material lien or encumbrance; payment of any material liability; or making any material loan, advance, or guaranty.

- - Transaction Record of Seller's sale of assets. {Reference Section II.G.2}

Listing of tangible assets recently sold for cash, prior to March 30, other than in the ordinary course of business.

- - Schedule 2.8 Title {Reference II.H.}

Listing of property and other assets included in the Financial Statements to which Seller does not have good and marketable title.

- - Schedule 2.9 Litigation {Reference II.I.}

Listing of material actions pending or threatened.

- - Schedule 2.10 Tax Matters {Reference II.J.}

Listing of deficiencies by Seller to prepare and submit required forms relative to taxes, and of deficiencies by Seller in paying taxes.

- - Schedule 2.13 Seller's Insurance {Reference II.M.}

Listing of list of each insurance policy maintained by Seller.

- - Schedule 2.14 Seller's Employees and Labor Relations {Reference II.N.}

Listing of exceptions to statements in Section II.N of the Agreement.

- - Schedule 2.16 Power of Attorney {Reference Section II.P.}

Listing of Seller's authorizations given for power of attorney, still in effect.

- - Schedule 2.17 [Agreement does not specify this Schedule]

- - Schedule 2.18 Seller's Agreements and Commitments {Reference Section II.R.}

Complete and accurate listing of each of Seller's agreements.

Listing of Attachments - (conclusion) -

- - Schedule 2.19 Seller's Personal Property {Reference Section II.S.}

Listing of all tangible personal property and assets owned or held by Seller and used or useful in the conduct of the business of Seller.
Notation of any such properties to which Seller does not have good title.

Copies of all leases and other agreements relating to the listed property.

- - Schedule 2.21 Seller's Patents, Trademarks, Tradenames, etc.

{Reference Section II.U.}

Accurate and complete listing of Seller's currently held and applied for patents, trademarks, tradenames, service marks, and copyrights. Listing of all written notices received by Seller alleging infringement of unlawful use of this property.

- - Schedule 2.22 Seller's ERISA and Related Matters {Reference Section II.V.}

A description of all "Employee Welfare Benefit Plans" and "Employee Pension Benefit Plans" currently maintained or contributed to by Seller. Listing of Seller's retirement or deferred compensation plan, savings, incentive, stock option or stock purchase plan, unemployment compensation plan, vacation pay, severance pay, bonus or benefit arrangement, insurance or hospitalization program, and any other fringe benefit arrangement for any employee, consultant or agent.

- - Schedule 3.1 [Agreement does not specify this Schedule]
- - Schedule 3.2 [Agreement does not specify this Schedule]
- - Schedule 3.3 [Agreement does not specify this Schedule]

- - Schedule 3.4 Purchaser's Obligations to Governmental Authorities Relative to This Agreement {Reference Section III.D.}

Description of Purchaser's obligations relative to this Agreement to governmental authorities.

EXHIBIT 11.1

SCHMITT INDUSTRIES, INC.

SCHEDULE OF COMPUTATION OF NET INCOME PER SHARE

	YEARS ENDED MAY 31,		
	1996	1995	1994
PRIMARY			
Net income for primary income per common share	\$1,217,253	\$248,805	\$181,503
Weighted average number of shares outstanding during the year	6,887,975	6,886,889	5,977,668
Add: common equivalent shares (determined using the "treasury stock" method) representing shares issuable upon exercise of employee stock options	528,738	228,905	225,210
Weighted average number of shares used in calculation of primary income per share	7,416,713	7,115,794	6,202,878
Primary income per common share	\$.16	\$.04	\$.03
FULLY DILUTED			
Net income for fully diluted net income per share	\$1,217,253	\$248,805	\$181,503
Weighted average number of shares used in calculating primary income per common share	7,416,713	7,115,794	6,202,878
Add (deduct) incremental shares representing:			
Shares issuable upon exercise of stock options included in primary calculation above	(528,738)	(228,905)	(225,210)
Shares issuable upon exercise of stock options based on year-end market price	557,374	228,905	225,210
Weighted average number of shares used in calculation of fully diluted income per share	7,445,349	7,115,794	6,202,878
Fully diluted income per common share	\$.16	\$.04	\$.03

TO OUR SHAREHOLDERS

1996 was a year of accelerated growth and increasing profitability for Schmitt Industries, Inc. Fiscal 1996 saw many changes in personnel and product diversification for the Company. The acquisition of SMS, Schmitt Measurement Systems, Inc., brought the state of the art laser based surface and distance measurement technologies into the Company.

SMS successfully introduced several new products to the computer disk drive and micro electronic wafer markets. The Company's new TMS-2000 computer disk measurement system is becoming the industry standard for surface measurement of disks for hard drives. It provides users the fastest, most accurate measurements of any product in the market.

Operating results for the year continued to show we have the correct combination of product, people, and management. Our sales increased 60% to \$7.1 million for the year, with net profits after tax increasing 390% to \$1.2 million. We expect sales of Balancer and Measurement products to increase again in fiscal 1997.

The Company continues to evolve and change in products, people, technology, and opportunities. The addition of the SMS subsidiary has brought new customers in the semiconductor, wafer, and computer hard disk drive markets. Newly patented laser based technologies created in Fiscal Year 1996 will continue to impact our future upward growth.

I am proud of the people and the results our Company has achieved during Fiscal 1996. Major changes and adjustments have been successfully implemented, such as: two new patents on the SMS TMS-2000 machine, completion of the remodeling of the SMS facility, over 50 new Balancer applications, more international customer demand for our products, and new SMS measurement products added to our product offering for the future.

As we look toward the future, we are reminded of our vision for the Company:

"TO PROVIDE THE BEST POSSIBLE PRODUCTS AND QUALITY FOR OUR CUSTOMER, TO PROVIDE CHALLENGING AND REWARDING EMPLOYEE OPPORTUNITIES, AND TO PROVIDE THE GREATEST POSSIBLE RETURN TO OUR SHAREHOLDERS"

[Photo] It is our goal in fiscal 1997 and beyond to continue to seek fulfillment of this vision for our Company.

Thank you for your continued interest and support.

/s/Wayne A. Case

Wayne A. Case
President &
Chairman of the Board

P.S. VISIT OUR NEW WEB SITE - <http://www.schmitt-ind.com>

COMPANY GROWTH

Increasing efficiency, excellent products, and the ability to recognize market opportunities has resulted in the dramatic growth, year after year, of our Company since its inception in 1986.

The fact that the SBS Dynamic Balance System operates at a much higher degree of accuracy and reliability than similar products and yet maintains a 10% to 20% pricing advantage has resulted in it becoming the standard of the industry.

The new SMS laser based measurement products brought into Schmitt in May of 1995 have added substantial technological depth to our product offerings, which has resulted in increased sales and profits.

Our products are utilized throughout the world by such industrial giants as The Boeing Company, General Motors Corporation, Ford Motor Company, Timken Bearings, Torrington Bearings, Mercedes Benz, and Daewoo International Corporation. New machine builders offer our SBS product integrated into their machine to worldwide users. The Schmitt SBS Dynamic Balance System, or similar products, are employed in the machine tool industry. They are utilized in instances where circular devices such as grinding wheels, fans, turbines, etc., need to be balanced initially and subsequently kept in balance in order to operate efficiently.

Our SBS Dynamic Balance System is production proven in over 4,500 major manufacturing installations. It is made in the U.S.A. to strict ISO-9001 quality and measurement standards. Most of our worldwide customers are sold on the spot when they see how quickly it installs and how fast it balances and pays for itself on their machine.

Our Company can measure surfaces via Laser Light Scatter to accuracy levels of one angstrom - a single angstrom is equal to 4 billionths of one inch! This level of accuracy is well beyond competitive measurement technologies and is an emerging requirement in the manufacture of silicon wafers for the semiconductor industry and in the manufacture of hard disks for the computer industry.

Laser based, positional measurement and alignment products are also offered by the company. Angles of alignment are now measured by Schmitt in 6/100th of a single degree. These SMS products represent extraordinary technological achievements that we will continue to refocus into the industrial markets.

NET PROFITS PER SHARE (After Tax)
OPERATING INCOME PER SHARE (Before Tax)

[Graph]

	1993	1994	1995	1996
Net Profits per Share	.04	.03	.04	.16
Operating Income per Share	.04	.05	.10	.20

OPERATING INCOME FOR
THE YEAR
[Graph]

1993	1994	1995	1996
\$231,831	\$313,129	\$697,410	\$1,509,158

SALES GROWTH [Graph]

1993	1994	1995	1996
\$1,728,608	\$2,574,998	\$4,414,832	\$7,080,128

COMPANY PROFILE

Schmitt Industries, Inc. is a global leader in the design, manufacturing and marketing of automatic balancing devices for rotating equipment, as well as laser based measurement products. Our primary objectives are to ensure total customer satisfaction by continually improving the quality and value of Schmitt products and services, providing all employees with challenging and rewarding opportunities to fully utilize their skills and talents in contributing to the success of Schmitt Industries, Inc., and earning above average profits and earnings for all of our shareholders.

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

The SBS system is fully automated and consequently, the user does not have to pre-balance such devices as grinding wheels. This reduces the setup time of such operations and ensures a smoother running and more efficient operation.

The SBS Dynamic Balance System operates on a principle of mass compensation for wheel imbalance. The balance head contains two movable eccentric weights, each of which is driven by electric motors through a precision gear train. These weights can be repositioned to offset any imbalance in a grinding wheel or other application. Imbalance or vibration is picked up by the sensor. The signal is fed to the controller, which filters the signal by revolutions per minute. The controller then drives the two balance head weights in the direction that reduces the amplitude of the vibration signal. When the weights are positioned so the lowest vibration level is reached, the balance cycle is complete.

[Graphic] [Graphic]

Typical end users own fleets of precision grinding machinery dedicated to production grinding where close tolerance of finished parts and consistency, wheel change time, part finish, and overall quality are all judged to be important. Users in these markets typically pay for their SBS System in four to six months through cost savings of downtime, wheel life improvements, as well as scrap reduction and part quality improvement.

Precision grinding is necessary in all major manufacturing areas such as the automotive industry (camshafts, crankshafts, valves), bearings (roller and tapered types), ceramics (precision shaping), electric motors (shafts), pumps (shafts turbines), aircraft (engine parts), and general manufacturing.

Precision grinding is increasing as a worldwide method of material removal and material processing. Therefore, the Company expects to see an increase in market growth and an increase in the need for automatic balancers.

The SBS Dynamic Balance System serves a variety of industrial markets throughout the world. The precision grinding industry is worldwide in scope and is established within all industrialized countries.

The Company's new subsidiary, SMS, Schmitt Measurement Systems, Inc., designs, produces and markets micro measurement products based on proprietary laser based technologies. These products include industrial measurement equipment for determining surface roughness at extremely accurate angstrom levels. Users of these technologies are producers of disks for computer hard drives and silicon wafer manufacturers. The new TMS-2000 non-contact laser based measurement machine consists of a measurement module as well as a stand-alone standard computer to provide software and record keeping for the user.

The SMS product line also includes laser light-scatter products utilized in space optics and military markets to measure the surface of precision ground camera and telescope lens.

SMS also provides laser surface measurement services to an international client list from the world's most powerful Light Scatter Laboratory. The CASI scatterometer is a research instrument for measuring scattered light. The way a surface scatters light relates to its roughness.

The measurements laboratory uses over 20 different wavelengths or "colors" of lasers from 0.325 microns in the ultraviolet to 10.6 microns in the infrared. Analysis software allows the user to calculate roughness and total integrated scatter. A Class 10 clean environment encloses the measurement area for measurement of semiconductor materials and space optics. Some applications include the semiconductor and hard disk industries, as well as critical optical components in aerospace and defense systems. The measurement lab is used for contract measurements, new instruments research and development, and proof of concept measurements.

The Company's business is conducted with many customers who are located throughout the world.

[Photos}

FOR THE YEAR ENDED MAY 31, 1996

(WITH COMPARATIVE AUDITED FIGURES FOR THE YEAR ENDED MAY 31, 1995)

CONSOLIDATED BALANCE SHEETS

	1996	1995
ASSETS		
Current Assets:		
Cash	\$ 508,240	\$ 141,244
Trading securities	145,600	356,822
Accounts receivable	1,411,805	967,781
Inventories	1,781,331	1,182,913
Prepaid expenses	15,906	11,902
Notes receivable	--	10,000
Income taxes receivable	--	50,000
Deferred tax asset	593,740	--
	-----	-----
Total current assets	4,456,622	2,720,662
Property and Equipment:		
Land	299,000	299,000
Building and leasehold improvements	834,850	589,320
Furniture, fixtures, and equipment	556,245	396,917
Vehicles	104,126	104,126
	-----	-----
	1,794,221	1,389,363
Less accumulated depreciation	312,189	117,985
	-----	-----
	1,482,032	1,271,378
	-----	-----
Other Assets:		
Marketing rights, net of accumulated amortization of \$663,521 and \$588,803 at May 31, 1996 and 1995, respectively	72,393	147,111
Goodwill	--	433,839
Intellectual property	--	45,527
	-----	-----
Total other assets	72,393	626,477
	-----	-----
TOTAL ASSETS	\$6,011,047	\$4,618,517
	-----	-----
	-----	-----
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Trade accounts payable	\$ 344,828	\$ 441,043
Accrued liabilities	244,613	117,829
Current portion of long-term debt	40,346	--
Current portion of mortgage loan payable	--	12,871
Income taxes payable	294,749	--
	-----	-----
Total current liabilities	924,536	571,743
Mortgage Loan Payable, net of current portion	--	221,049
Long-Term Debt, net of current portion	174,532	362,094
Long-Term Deferred Tax Liability	25,107	--
Commitments and Contingencies		
Stockholders' Equity		
Common stock, no par value, 20,000,000 and 19,000,000 shares authorized and 6,918,139 and 6,886,889 shares issued and outstanding at May 31, 1996 and 1995, respectively	4,098,512	3,892,524
Retained earnings (accumulated deficit)	788,360	(428,893)
	-----	-----
TOTAL STOCKHOLDERS' EQUITY	4,886,872	3,463,631

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

\$6,011,047

\$4,618,517

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

FOR THE YEAR ENDED MAY 31, 1996

(WITH COMPARATIVE AUDITED FIGURES FOR THE YEARS ENDED MAY 31, 1995 AND 1994)

CONSOLIDATED STATEMENTS OF INCOME

	1996	1995	1994
SALES	\$7,080,128	\$4,414,832	\$2,574,998
COST OF SALES	2,547,054	1,656,462	1,025,157
	-----	-----	-----
GROSS PROFIT	4,533,074	2,758,370	1,549,841
	-----	-----	-----
GENERAL, ADMINISTRATIVE, AND SALES EXPENSE	3,023,916	2,045,117	1,126,049
RESEARCH AND DEVELOPMENT EXPENSE	--	15,843	110,663
	-----	-----	-----
OPERATING EXPENSES	3,023,916	2,060,960	1,236,712
	-----	-----	-----
OPERATING INCOME	1,509,158	697,410	313,129
	-----	-----	-----
OTHER INCOME AND EXPENSE			
Interest expense	(45,130)	(26,756)	(20,536)
Interest income	27,853	56,978	6,309
Gain (loss) on sale of assets	--	2,512	(7,560)
Loss on write down of assets	(61,222)	(333,832)	--
Miscellaneous income	16,132	19,263	7,389
	-----	-----	-----
	(62,367)	(281,835)	(14,398)
INCOME BEFORE PROVISION FOR INCOME TAXES	1,446,791	415,575	298,731
PROVISION FOR INCOME TAXES	229,538	166,770	117,228
	-----	-----	-----
NET INCOME	\$1,217,253	\$ 248,805	\$ 181,503
	-----	-----	-----
NET INCOME PER COMMON SHARE AND COMMON SHARE EQUIVALENT	\$.16	\$.04	\$.03
	-----	-----	-----
WEIGHTED AVERAGE NUMBER OF COMMON SHARES AND COMMON SHARE EQUIVALENTS OUTSTANDING	7,416,713	7,115,794	6,202,878
	-----	-----	-----

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

For The Year Ended May 31, 1996
(WITH COMPARATIVE AUDITED FIGURES FOR THE YEARS ENDED MAY 31, 1995 AND 1994)

CONSOLIDATED STATEMENTS OF CASH FLOWS

	1996	1995	1994
CASH FLOWS RELATING TO OPERATING ACTIVITIES			
Net income	\$ 1,217,253	\$ 248,805	\$ 181,503
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation	196,021	77,211	32,528
Amortization	189,103	148,325	116,230
Write-down of investments	61,222	-	-
Deferred taxes	(30,822)	51,000	(51,000)
Write-down of marketing rights	-	333,382	-
(Gain) loss on sale of assets	-	(2,512)	7,560
(Increase) decrease in:			
Trading securities	150,000	(356,822)	-
Accounts receivable	(444,024)	(210,472)	(218,006)
Inventory	(613,626)	(482,485)	(227,138)
Prepaid expenses	(4,004)	2,213	(8,703)
Notes Receivable	10,000	(10,000)	-
Income taxes receivable	50,000	(50,000)	-
Other assets	(121,907)	372	473
Increase (decrease) in:			
Accounts payable	(96,215)	59,492	91,822
Accrued liabilities	126,784	52,048	-
Income taxes payable	294,749	(168,228)	169,228
	-----	-----	-----
Net cash provided by (used in) operating activities	984,534	(307,671)	93,497
	-----	-----	-----
CASH FLOWS RELATING TO INVESTING ACTIVITIES			
Purchase of property and equipment	(406,675)	(561,799)	(464,736)
Proceeds from sale of equipment	-	5,000	390
Acquisition of TMA Technologies, Inc.	-	(530,240)	-
	-----	-----	-----
Net cash used in investing activities	(406,675)	(1,087,039)	(464,346)
	-----	-----	-----
CASH FLOWS RELATING TO FINANCING ACTIVITIES			
Net increase (decrease) in short-term debt	-	(200,000)	200,000
Repayment of long-term debt	(69,131)	-	-
Long-term borrowings (repayments) - mortgage	(233,920)	(38,202)	272,122
Net change in lease payable	-	(4,431)	(5,906)
Dividends paid	-	(99,630)	-
Issuance of common stock (net of issuance costs of \$84,000)	-	-	1,427,848
Exercise of stock options	92,188	-	115,150
	-----	-----	-----
Net cash (used in) provided by financing activities	(210,863)	(342,263)	2,009,214
	-----	-----	-----
INCREASE (DECREASE) IN CASH	\$ 366,996	\$(1,736,973)	\$ 1,638,365
CASH, BEGINNING OF YEAR	141,244	1,878,217	239,852
	-----	-----	-----
CASH, END OF YEAR	\$ 508,240	\$ 141,244	\$1,878,217
	-----	-----	-----

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

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

	1996	1995	1994
Cash paid during the period for interest	\$ 45,130	\$ 26,756	\$ 20,536
Cash paid during the period for income taxes	\$ 11,600	\$ 321,997	\$ -

SUPPLEMENTAL SCHEDULE OF NON CASH INVESTING AND FINANCING ACTIVITIES

Discount associated with long-term debt	\$ (78,085)
Reduction of goodwill and intangible assets	\$(424,011)
Income tax benefit of stock options exercised	\$(113,800)

On May 23, 1995, Schmitt Industries, Inc. acquired TMA Technologies, Inc.

The purchase price consisted of the following:

Accounts receivable	\$ 208,574
Inventory	72,342
Property, plant, and equipment	306,714
Intellectual property	45,527
Goodwill	433,839
Accounts payable	(174,662)
Long term debt	(362,094)

Net cash paid to acquire TMA Technologies, Inc.

\$ 530,240

Cash dividend declared, payable June 30, 1994

\$ - \$ - \$ 99,630

For The Year Ended May 31, 1996

(WITH COMPARATIVE AUDITED FIGURES FOR THE YEARS ENDED MAY 31, 1995, 1994 AND 1993)

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	ISSUED SHARE CAPITAL		RETAINED EARNINGS	TOTAL
	NUMBER OF SHARES	AMOUNT \$	(ACCUMULATED DEFICIT)	SHAREHOLDERS' EQUITY
BALANCE, MAY 31, 1993	5,723,058	\$2,349,526	\$(759,571)	\$1,589,955
Stock options exercised	563,831	115,150	-	115,150
Issuance of stock (\$2.38 per share)	600,000	1,427,848	-	1,427,848
Cash dividend declared (\$.015 per share payable on June 30, 1994)	-	-	(99,630)	(99,630)
Net income for the year	-	-	181,503	181,503
BALANCE, MAY 31, 1994	6,886,889	3,892,524	(677,698)	3,214,826
Net income for the year	-	-	248,805	248,805
BALANCE, MAY 31, 1995	6,886,889	3,892,524	(428,893)	3,463,631
Stock options exercised	31,250	92,188	-	92,188
Income tax benefit from exercise of stock options	-	113,800	-	113,800
Net income	-	-	1,217,253	1,217,253

BALANCE, MAY 31, 1996

6,918,139

\$4,098,512

\$ 788,360

\$4,886,872

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

NOTES

1. ORGANIZATION AND NATURE OF OPERATIONS

Schmitt Industries, Inc. is engaged in the design, assembly, marketing and distribution of electronic and mechanical components for industrial products and laser measurement systems throughout the United States, the Far East, and Europe.

Schmitt Industries Inc. was incorporated in 1984 under the laws of British Columbia, Canada.

On December 7, 1993, Schmitt Industries Inc. established a wholly-owned subsidiary, Schmitt Industries, Inc. (an Oregon corporation), and transferred all assets and liabilities to the wholly-owned subsidiary in exchange for 1,000 shares of common stock.

On February 16, 1996, the shareholders of Schmitt Industries Inc., approved the continuance of the entity from British Columbia, Canada, to Wyoming and the simultaneous merger of the continued company into its wholly-owned subsidiary, Schmitt Industries, Inc. (the Company). As a result of the continuation and merger, the Company changed its legal domicile to Oregon and is no longer subject to the laws of British Columbia, Canada.

On October 16, 1995, the Company restated its Articles of Incorporation to authorize 20,000,000 shares of common stock.

On May 23, 1995, the Company acquired TMA Technologies, Inc. As of June 1, 1995, the name of this company was changed to Schmitt Measurement Systems, Inc.

The financial statements as of May 31, 1996 and 1995, and for the fiscal years ended May 31, 1996, 1995, and 1994, include those of the Company and its wholly-owned subsidiary. All significant intercompany accounts and transactions have been eliminated in the preparation of the consolidated financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. OTHER ASSETS

MARKETING RIGHTS

The capitalized costs of marketing rights are recorded at cost and are amortized on a straight-line basis over five to ten years. Amortization expense for the fiscal years ended May 31, 1996, 1995, and 1994, was \$74,718, \$141,936, and \$116,230, respectively.

GOODWILL AND INTELLECTUAL PROPERTY

Goodwill and intellectual property were acquired in the purchase of TMA Technologies, Inc., on May 23, 1995. The cost of both assets together with additionally acquired goodwill (see Note 3) are being amortized using the straight-line method over five years. Amortization expense for the fiscal year ended May 31, 1996, was \$99,177.

B. INVENTORY

Inventory is valued at the lower of cost or market. Cost is determined on the average cost basis. The classification of inventories is as follows:

	Years Ended May 31,	
	1996	1995
Raw materials	\$ 931,095	\$ 515,608
Work-in-process	122,403	73,277
Finished goods.	727,833	594,028
	-----	-----
	\$1,781,331	\$1,182,913
	-----	-----
	-----	-----

C. DEPRECIATION

Depreciation is computed by the straight-line method over the following estimated useful lives:

- Vehicles. 3 years
- Furniture, fixtures, and

equipment 3 - 7 years

Building and leasehold improvements. 25 years

Depreciation expense for the fiscal years ended May 31, 1996, 1995, and 1994, was \$196,021, \$77,211, and \$32,528, respectively.

D. CAPITAL STOCK

The Company follows the practice of recording amounts received upon the exercise of options by crediting common stock. No charges are reflected in the consolidated statements of operations as a result of the grant or exercise of stock options. The Company realizes an income tax benefit from the exercise or early disposition of certain stock options. This benefit results in an increase in common stock and deferred tax assets.

E. CONCENTRATION OF CREDIT RISK

Financial instruments which potentially expose the Company to concentration of credit risk are trade accounts receivable. Credit terms generally include a discount of 1 1/2% if the invoice is paid within 10 days, with the net amount payable in 3 days. No allowance for doubtful accounts is considered necessary.

For the fiscal years ended May 31, 1996, approximately 15.4% of consolidated sales were made to one customer by Schmitt Measurement Systems, Inc. As of May 31, 1996, the total amount of receivables from this customer was current. For the fiscal years ended May 31, 1995 and May 31, 1994, sales to a single customer did not exceed 10% of total sales.

F. INCOME TAXES

The Company follows the asset and liability method of accounting for income taxes whereby deferred tax assets and liabilities are recognized for the future tax consequences of differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

G. RESEARCH AND DEVELOPMENT COSTS

Research and development costs are charged to expense when incurred.

H. TRADING SECURITIES

Trading securities consist of common stock and are stated at fair value, which is estimated based on quoted market prices.

I. USE OF ESTIMATES

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates include the costing of inventory, labor and overhead, and the valuation of deferred tax assets.

J. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of financial instruments approximate their fair values at May 31, 1996. The fair market value of long-term debt approximates carrying amounts based on discounted cash flow analyses.

K. RECLASSIFICATIONS

Certain reclassifications have been made to the 1995 and 1994 financial statements to conform with current year presentations.

NOTES

3. ACQUISITION OF TMA TECHNOLOGIES, INC. (SCHMITT MEASUREMENT SYSTEMS, INC.)

On May 23, 1995, in a business combination accounted for as a purchase, the Company acquired TMA Technologies, Inc., which designs, manufactures, and markets optical quality assurance instruments. The results of operations of TMA Technologies, Inc., are included in the accompanying consolidated financial statements since the date of acquisition. The total cost of the acquisition was \$530,240, which exceeded the fair value of the net assets of TMA Technologies, Inc., by \$433,839. The excess is being amortized by the straight-line method over five years.

The summarized assets and liabilities of TMA Technologies, Inc., on May 23, 1995, the date of acquisition, were as follows:

Cash	\$ 4,877
Accounts receivable.	208,574
Inventory.	72,342
Property, plant, and equipment	306,714
Intellectual property.	45,527
Goodwill	433,839
Accounts payable	(173,662)
Long-term debt	(362,094)

	535,117
Less cash included above	(4,877)

Net cash paid to acquire	
TMA Technologies, Inc.	\$ 530,240

Subsequent to this addition, the Company changed the name of TMA Technologies, Inc., to Schmitt Measurement Systems, Inc., and moved the operations to Portland, Oregon.

In transactions related to the acquisition, the Company established a royalty pool and has vested each shareholder and debt holder an interest in the royalty pool equal to the amount actually invested by shareholders or loaned by debt holders including interest payable through March 31, 1995. The royalty pool will be funded in the future at 5% of net sales (defined as gross sales less returns, allowances and sales commissions) of Schmitt Measurement Systems, Inc.'s, products and future derivative products developed by Schmitt Industries, Inc., which utilize these technologies.

As part of the royalty pool agreement, each of the former shareholders and debt holders released TMA Technologies, Inc., and Schmitt Industries, Inc., for any claims with regard to the acquisition except their rights to future royalties.

Three debt holders, with a combined amount outstanding at May 31, 1995, of \$362,094, declined to participate in the royalty pool which was established as part of the acquisition of TMA Technologies, Inc., and demanded full payment of the amount due. The debt holders filed an action before the U.S. Bankruptcy Court in Montana in an attempt to cause repayment through liquidation of the Company. The Company successfully

converted this action to a reorganization process.

In April 1996, the Company's Plan of Reorganization was approved by the U.S. Bankruptcy Court for the District of Montana. The approved Plan requires the three debt holders to accept the terms of the royalty pool agreement but further requires the Company to purchase the three debtors' interests, as follows: April 29, 1996 - \$91,068; March 29, 1997 - \$54,640; March 29, 1998 - \$43,713; March 29, 1999 - \$34,970; March 20, 2000 - \$139,880. The outstanding balance at May 31, 1996, based on the present value of the debt, discounted at 8% per annum, was \$214,878, of which \$40,346 was classified as current.

In the event that the remaining unpaid balance of the royalty pool interest is not purchased in full on or before March 29, 1998, the remaining balance due will accrue interest at 8% per annum. In addition, the Company has the option of purchasing the remaining unpaid balance of the royalty pool interests on or before March 29, 1999, at a 10% discount of the amount then due.

The approved Plan also requires the Company to segregate the royalty pool payments to the former Chief Executive Officer of TMA Technologies, Inc., in an interest-bearing trust account pending the outcome of actions involving TMA Technologies, Inc.,

a/k/a Toomay, Mathis & Associates, Inc., and Schmitt Industries, Inc., plaintiffs, v. Robert C. Mathis and Marvin H. Ball, defendants together with corresponding countersuits initiated in the U.S. District Court for the District of Montana. The extent of potential liability, if any, related to this matter cannot be estimated at this time.

NOTES

4. LINE OF CREDIT

The Company has a line of credit with the Union Bank of California, Portland, Oregon, to a maximum of \$250,000. The line is secured by accounts receivable, investments, and inventory. Interest is payable monthly on the outstanding balance at the bank prime lending rate plus 1% per annum. The Company has no balance owing at either May 31, 1996 or 1995. This line of credit expires September 30, 1996.

Subsequent to May 31, 1996, the Company entered into an unsecured short-term line of credit agreement with Wells Fargo Bank, to a maximum of \$1,500,000. The line is guaranteed by the Company's wholly-owned subsidiary, Schmitt Measurement Systems, Inc. Interest is payable at the bank's prime rate, fully floating.

5. MORTGAGE LOAN PAYABLE

The mortgage loan payable of \$233,920 at May 31, 1995, was secured by a first mortgage on the land and building located at 2765 N.W. Nicolai Street, Portland, Oregon. The mortgage was payable in 60 monthly payments of \$2,831, including interest at 9.25% per annum, commencing February 1, 1994, with the balance due in full on January 1, 1999.

The balance outstanding was paid in full during the fiscal year ended May 31, 1996.

6. CONTINGENCY

The Company is party to a legal action by a competitor alleging wrongful misrepresentation of the competitor's product. The claim is considered by management and the Company's legal counsel, to be without merit. The extent of potential liability, if any, cannot be estimated at this time.

7. STOCK OPTIONS

Prior to 1995, the Company periodically granted stock options to Directors and employees of the Company. Stock options for up to 10% of the number of outstanding shares may have been granted provided that the stock options for any one individual did not exceed 5% of the issued and outstanding shares of common stock. The purchase price of the optioned shares must have been equal to not less than the average closing price of the Company's common stock for the ten trading days immediately preceding the grant date of the stock options. The maximum term of each stock option may not exceed five years and all stock options were vested and exercisable upon granting.

The following summarizes the options outstanding as of May 31, 1996:

	Number of Shares	Price Per Share	Expiration Date
Options granted in 1994:			
	277,500	\$1.93	2/4/1999
	312,000	\$1.42	1/7/1999
	25,000	\$1.42	1/7/1999

Options under grant, May 31, 1994.....	614,500		

Options exercised in 1995.....	-		
Options expired in 1995.....	-		
Options granted in 1995.....	-		

Options under grant, May 31, 1995.....	614,500		

Options exercised in 1996	(18,750)	\$1.42	
Options expired in 1996	-		
Option granted in 1996	-		

Options under grant, May 31, 1996.....	595,750		

On April 19, 1996, the Company filed a Form S-8 Registration Statement under the Securities Act of 1933 with the Securities and Exchange Commission in order to register 300,000 shares of common stock for future

issuance under the Schmitt Industries, Inc., 1995 Stock Option Plan.

The 1995 Stock Option Plan was adopted by the Board of Directors on December 19, 1995. An option granted under the Plan may be either an incentive stock option ("ISO"), or a nonstatutory stock option ("NSO"). ISOs may be granted only to employees of the Company and are subject to certain limitations, in addition to restrictions applicable to all stock options under the Plan. Options not meeting these limitations will be treated as NSOs.

Options granted under the Plan are not exercisable until vested. Vesting is generally on a cumulative basis over four years at 25% per year.

The following summarizes the options outstanding under the 1995 Stock Option Plan as of May 31, 1996:

	NUMBER OF SHARES	PRICE PER SHARE	EXPIRATION DATE
Options granted in 1996	295,000	\$4.375-9.75	2006
Options exercised in 1996	(12,500)	\$ 4.375	

Options under grant May 31, 1996	282,500		

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123), which is effective for transactions entered into for fiscal years that begin after December 15, 1995. SFAS 123 established a fair value-based method of accounting for stock-based compensation plans. The Company will adopt the disclosure method

in 1997. The Company does not anticipate SFAS 123 to have a material effect on the Company's financial position or results of operations in fiscal 1997.

8. EMPLOYEE BENEFIT PLANS

The Company adopted a Simplified Employee Pension Plan (SEP) during the fiscal year ended May 31, 1993. All permanent employees were eligible to participate once they met the age and length of employment requirements. Contributions were \$41,840, \$40,500, and \$24,000 during the fiscal years ended May 31, 1996, 1995, and 1994, respectively. The Plan was terminated effective May 31, 1996.

The Company adopted the Schmitt Industries, Inc. 401(k) Profit Sharing Plan & Trust on May 15, 1996, to be 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 will be matched by the Company. The Company may further contribute matching contributions (to employees who have deferred a certain percentage of their compensation), a profit sharing contribution, or a discretionary contribution. No contributions were made to this Plan during the fiscal year ended May 31, 1996.

NOTES

9. SEGMENTS OF BUSINESS

The Company operates principally in two segments of business. Schmitt Industries, Inc., manufactures mechanical components for the machine tool industry and Schmitt Measurement Systems, Inc., manufactures laser measurement systems for the computer disk industry. There were no intersegment sales and, therefore, revenues from unaffiliated customers represent total revenues as reported in the Company's consolidated statement of income and were \$4,801,151 and \$2,278,977, for Schmitt Industries, Inc., and Schmitt Measurement Systems, Inc., respectively for the year ended May 31, 1996. Income from operations for the year ended May 31, 1996 was \$648,777 for Schmitt Industries, Inc., and \$860,381 for Schmitt Measurement Systems, Inc. Identifiable assets at May 31, 1996, were \$4,187,316 and \$1,823,731 for Schmitt Industries, Inc., and Schmitt Measurement Systems, Inc., respectively. The operations of Schmitt Measurement Systems, Inc., were immaterial for the year ended May 31, 1995.

Income from operations represents sales less costs and operating expenses. Depreciation expense incurred during the year ended May 31, 1996, by Schmitt Industries, Inc., and Schmitt Measurement Systems, Inc., was \$115,778 and \$80,243, respectively. Amortization expense was \$91,756 and \$97,347, and capital expenditures were \$317,861 and \$88,814, for Schmitt Industries, Inc., and Schmitt Measurement Systems Inc., respectively.

Identifiable assets by segment of business are those assets used in the Company's operations in each segment. There are no unallocated corporate assets.

10. INCOME TAXES

Deferred income taxes are recognized for all significant temporary differences between the tax and financial accounting bases of assets and liabilities. The classification of the resulting deferred tax assets and liabilities is based upon the classification of the related balance sheet asset or liability. The deferred tax asset results principally from net operating loss carryforwards and temporary differences in the expense recognition of certain accounts. The deferred tax liability results from using accelerated depreciation methods for tax purposes.

The principal components of the deferred tax assets and liabilities are as follows:

	YEARS ENDED MAY 31,	
	1996	1995
DEFERRED TAX ASSETS:		
Net operating loss		
carry forward.....	\$ 1,591,229	\$ 1,872,642
Exercise of sock options.....	113,800	-
Inventory capitalization.....	39,066	-
Other deferred assets.....	16,863	-
	-----	-----
	1,760,958	1,872,642
Valuation allowance.....	(1,167,218)	(1,872,642)
	-----	-----
	\$ 593,740	\$ -
	-----	-----
DEFERRED TAX LIABILITIES:		
Depreciation.....	\$ 25,107	\$ -
	-----	-----
NET DEFERRED TAX ASSETS:.....	\$ 568,633	\$ -
	-----	-----

Through the acquisition of Schmitt Measurement Systems, Inc., the Company acquired net operating loss carry forwards in the amount of \$5,507,768. These carryforwards expire in the years 2002 through 2010 and as of May 31, 1996, \$4,680,084 of the net operating loss carryforwards remain. A valuation allowance is provided when it is more likely than not that some portion or all of the operating loss will not be realized. Since all of the net operating losses associated with the acquisition might not be realized, a valuation allowance was established for the entire balance at May 31, 1995. As of May 31, 1996, the valuation allowance has been reduced since it is more likely than not that some portion of the operating loss will be realized. The reduction in the valuation allowance has been accounted for as a reduction of goodwill and intangible assets associated with the purchase acquisition.

A reconciliation between the statutory federal income tax rate and the effective tax rate is as follows:

	YEARS ENDED MAY 31,		
	1996	1995	1994
Federal income taxes at statutory rate.....	\$ 491,909	\$141,296	\$101,568
State income taxes, net of federal income tax benefit.....	31,511	18,103	13,013
Change in deferred tax valuation allowance.....	(705,424)	-	-
Reduction of goodwill and intangible assets associated with the acquisition of Schmitt Measurement Systems, Inc.....	424,011	-	-
Canadian income taxes.....	-	-	57,728
Effect of research and development costs capitalized for tax purposes.....	-	-	(51,000)
Other.....	(12,469)	7,371	(4,081)
	-----	-----	-----
Provision for income taxes-current.....	\$ 229,538	\$166,770	\$117,228
	-----	-----	-----
Effective tax rate.....	16%	40%	39%
	-----	-----	-----

11. EARNINGS PER SHARE

Earnings per share were computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents outstanding for the years ended May 31, 1996, 1995, and 1994. Common stock equivalents include the number of shares issuable on exercise of the outstanding options less the number of shares that would have been purchased with the proceeds from the exercise of the options based on the average price of common stock during the year for primary net income per common share and the closing market price of common stock for fully diluted net income per common share. There is no difference between primary and fully diluted net income per share calculations for the years ended May 31, 1996, 1995, and 1994.

GENERAL

The following information contains certain forward-looking statements that anticipate future trends or events. These statements are based on certain assumptions that may prove to be erroneous and are subject to certain risks including but not limited to the uncertainties of the Company's new product introduction and the risks of increased competition and technological change in the Company's industry and the risk factors listed from time to time in the Company's SEC reports, including but not limited to the Current Report in Form 8-K dated June 5, 1996. Accordingly, actual results may differ, possibly materially, from the predictions contained herein.

MANAGEMENT'S DISCUSSION & ANALYSIS

The Company began initial product deliveries in 1988, focusing primarily on the sale of earlier versions of the SBS Dynamic Balance System for machine tool builders producing grinding machines. The Company established itself as a major supplier in the automatic balancing market. The Company became profitable in Fiscal 1991, and has reported profitable results for each succeeding year with increases in sales and earnings for each year. There can be no assurance that the Company will continue to be profitable with increased sales levels in future periods.

Sales outside the United States accounted for approximately 10% of the Company's revenues in each of the Fiscal 1994, 1995 and 1996. Some foreign customers will purchase in their own country's currencies, thereby imposing on the Company a currency risk. All U.S. sales (90% of total sales) are in U.S. dollars and less than 2% of total sales are in currencies other than U.S. dollars; as a result, currency fluctuations have historically had little impact on revenue realization. However, significant variations in the value of the U.S. dollar, relative to currencies of countries in which the Company has significant competitors, can impact future sales. The Company does not engage in currency hedging. In addition, longer payment cycles of international sales can have a negative impact on liquidity. The Company believes that international sales will continue to grow in future periods.

A substantial portion of the Company's revenues are derived from sales to end users through selling agents and directly to builders of machine tools. For Fiscal 1995 and 1996, sales to a single customer did not exceed 10% of total revenues. The Company is dependent on the sales activities of its selling agents, and there can be no assurance that these agents will continue to be successful in their efforts to market the Company's products. The Company enjoys substantial repeat business from a broad base of customers, but there can be no assurance that these customers will continue to buy the Company's products in the future.

Increased revenues during Fiscal 1994, 1995 and 1996 principally have been the result of increased volume of product shipments. Product improvements and available features have resulted in modestly increased average product prices.

RESULTS OF OPERATIONS

Sales in Fiscal 1996 increased to \$7,080,628 from \$4,414,832 in Fiscal 1995 and \$2,574,998 in Fiscal 1994. The 60.4% increase in Fiscal 1996 was driven by across-the-board gains in orders from both domestic and international customers. Management believes that the increase in sales resulted from improved marketing coverage and advertising and the weakening of domestic competitors. Additionally, SMS sales accounted for \$2,278,977 of Fiscal 1996 sales as the newly introduced TMS-2000 Non-Contact Laser Texture Measurement machine had increased shipments.

The Company has enjoyed a high gross profit on its SBS Dynamic Balancing products and its SMS measurement products. Its cost of sales (cost of material and labor) as a percentage of sales has been declining over the last three fiscal years because of economies of scale associated with growth and shifting product mix. Costs of sales as a percentage of sales for Fiscal 1994, 1995 and 1996 was 39.4%, 37.5% and 35.9%, respectively. The introduction of the TMS-2000 during the third quarter of Fiscal 1996 had a positive impact on gross earnings and net earnings for Fiscal 1996. Cost of sales of SMS products was 28% of sales of such products for Fiscal 1996. SMS products accounted for sales of \$2,278,977 in Fiscal 1996 with income from SMS operations of \$860,381 in that period. Management anticipates that cost of sales as a percentage of sales for SMS products will be similar to the SBS products. Management expects that added costs associated with operating SMS will continue to be more than offset by increased revenue, although no assurances can be made that the new subsidiary will be profitable or will generate increased sales.

Operating expenses as a percentage of sales in Fiscal 1994, 1995, and 1996 are 48%, 46% and 43% respectively. Sales expense was the largest category, consuming 21%, 18% and 15.3% of operating expenses during Fiscal 1994, 1995 and 1996, respectively. Sales expense increased primarily as a result of expansion and upgrading of the Company's sales force and the hiring of additional sales people to allow top Company management to devote a greater percentage of time to corporate operations and less to sales. The acquisition of Schmitt Measurement Systems, Inc., ("SMS") late in Fiscal 1995 and relocation of the business from Montana to Oregon required

additional expenditures for travel, legal, accounting, moving costs, literature and miscellaneous office equipment in Fiscal 1995 and 1996.

The Company has had minor variable cost increases in periods of increased sales; therefore, fixed costs have been in past years amortized over an increasing sales revenue

as unit sales of SBS products increased. Even with two operating businesses, management believes the Company's cost of sales will not increase at the same rate that sales are anticipated to increase in Fiscal 1997, although there can be no such assurance.

Net income for Fiscal 1996 rose to \$1,217,253, a 489% increase over Fiscal 1995 and 671% increase over Fiscal 1994. Net income per share increased to \$0.16 in Fiscal 1996 from \$0.04 in Fiscal 1995 and \$0.03 in Fiscal 1994.

LIQUIDITY & CAPITAL RESOURCES

The Company satisfied its cash requirements from 1986 through 1988 from sales of common stock and the exercising of stock options as well as from operations. Since 1989, the Company's cash requirements have been satisfied primarily through operations, although in Fiscal 1994 the Company completed a \$1.4 million Common Stock offering. At May 31, 1996, the Company had cash and cash equivalents on hand of \$653,840 compared with \$498,066 at May 31, 1995 and \$1,878,217 at May 31, 1994.

Accounts receivable have increased as revenue has increased. At May 31, 1996 accounts receivable totaled \$1,411,805 compared with \$967,781 at May 31, 1995 and \$548,735 at May 31, 1994. At May 31, 1996, none of the Company's accounts receivable were considered a doubtful collection. The Company generally experiences a payment cycle of 30 - 80 days on invoices, with some customers taking advantage of the 1.5% cash discount offered by the Company. Most Company customers are Fortune 500 companies, which creates minimal risk of accounts receivable collection. In the event of repeated collection problems, the Company ships on a C.O.D. basis, and currently has only one customer on a C.O.D. basis. Management believes its credit policies and collection policies are effective and appropriate for the marketplace that it serves and has had no bad debt write-offs since its inception in 1986. There can be no assurance that the Company's collection procedures will continue to be successful.

Working capital increased from \$2,331,399 at May 31, 1994 to \$2,148,919 at May 31, 1995 and to \$3,532,086 at May 31, 1996. Capital expenditures for property and equipment totaled \$464,736, \$561,799 and \$406,675 during Fiscal 1994, 1995 and 1996, respectively. Increases in capital expenditures during Fiscal 1994 and 1995 were the result of the purchases of new and additional facilities. In addition, the Company spent \$530,240 during Fiscal 1995 on the acquisition of SMS. Fiscal 1996 capital expenditures totaled \$88,814 for SMS. Although the Company has no current material commitments for capital expenditures, product development to extend SBS products to new markets and to bring SMS products to advanced commercial status is expected to result in modest capital expenditures for equipment in Fiscal 1997.

The Company maintains levels of inventory sufficient to satisfy normal customer demands, plus an increasing short term delivery requirement for a majority of its products. Additionally, inventories are periodically adjusted according to management's forecast for future business activity. Management believes its ability to provide prompt deliveries gives it a competitive advantage for certain sales. It is expected that current inventory levels will be maintained or increased as new products are introduced. The average inventory turnover ratio for Fiscal 1994, 1995, and 1996 was 4.9x, 4.9x and 4.9x, respectively. The large increase in inventory during Fiscal 1994 (69% increase from May 31, 1993) was the result of the Company's commitment to supplying field demonstration units, increased sales demand, a diversification of the product line with a disproportionately large increase in inventory, and temporary increase in inventory above "normal" levels to take advantage of quantity purchase opportunities at fiscal year end. The large increase in inventory during Fiscal 1995 (86% increase from May 31, 1994) related to increased sales demand, advantageous acquisition of quantity purchases, and the addition of SMS product inventory. The 50% increase in inventory from May 31, 1995 to May 31, 1996 was the result of establishing additional inventory to support both finished goods and raw materials for SMS products.

In December 1993, the Company acquired an office/manufacturing facility, tripling the square footage relative to its prior facility. As a result of the new facility, operational efficiency has been improved; in addition, the monthly costs of the mortgage, heat and lights in Fiscal 1996 was less than the monthly amounts expended for the two previous fiscal years for the leased space the Company had utilized.

In April and May 1995, the Company expended \$530,240 in the acquisition of SMS and invested approximately \$300,000 in additional funds in the remodeling of an older 33,000 square foot building to house the business. SMS currently occupied 7,000 square feet of that facility with some of the remaining space leased to third parties of offset expenses.

During Fiscal 1995, the Company implemented several actions which resulted in the deferral or reduction of income taxes in Fiscal 1995 and beyond. The Company wrote down its investment in the Infrasonic Alarm System to \$0 (\$333,832 writedown), and wrote-off more than \$50,000 in inventory. These actions reduced

income tax payments during Fiscal 1995 by approximately \$150,000. Additionally, the acquisition of SMS during the next fifteen years, at the rate of approximately \$325,000 of tax savings per year.

Management believes that its cash flow from operations, available credit resources and its improving cash position will provide adequate funds on both a short-term and long-term basis to cover currently foreseeable debt payments, lease commitments and payments under existing and anticipated supplier agreements. Management believes that such cash flow (without the raising of external funds) is sufficient to finance current operations, projected capital expenditures, anticipated long-term sales agreements and other expansion-related contingencies during Fiscal 1997.

SELECTED FINANCIAL DATA

In thousands, except per share information

	YEAR ENDED 5/31/96	YEAR ENDED 5/31/95	YEAR ENDED 5/31/94	YEAR ENDED 5/31/93	YEAR ENDED 5/31/92
Sales	\$7,080	\$4,415	\$2,575	\$1,729	\$1,102
Net Income	\$1,217	\$ 249	\$ 182	\$ 236	\$ 91
Earnings Per Share Before Extraordinary Item	\$ 0.16	\$ 0.04	\$ 0.03	\$ 0.03	\$ 0.01
Extraordinary Item	-	-	-	\$ 0.01	\$ 0.01
Net Income Per Share	\$ 0.16	\$ 0.04	\$ 0.03	\$ 0.03	\$ 0.01
Weighted Avg. No. Shares (000)	7,417	7,116	6,203	5,661	5,623
Deferred Development Costs-Current Period	-	-	\$ 111	\$ 31	\$ 14
Deferred Development Costs-Cumulative	-	-	\$ 419	\$ 376	\$ 379
Stockholders' Equity	\$4,887	\$3,464	\$3,215	\$1,590	\$1,339
Total Assets	\$6,011	\$4,619	\$4,232	\$1,781	\$1,454

**MANAGEMENT'S
DISCUSSION & ANALYSIS**

SUMMARIZED QUARTERLY FINANCIAL DATA (UNAUDITED) BEFORE TAX

1996 QUARTER ENDED	AUGUST 31	NOVEMBER 31	FEBRUARY 28	MAY 31
Sales	\$1,340,771	\$1,520,028	\$1,855,938	\$2,363,391
Gross Profit	\$ 838,464	\$ 927,754	\$1,274,354	\$1,452,502
Net Income	\$ 83,392	\$ 208,099	\$ 484,288	\$ 441,474
Net Income Per Share	\$0.01	\$0.03	\$0.06	\$0.06
Cash Dividends Per Share	-	-	-	-
Market Price of Common Stock (1)				
Low	\$2.13	\$2.63	\$3.88	\$5.25
High	\$2.88	\$5.13	\$5.63	\$14.75
1995 QUARTER ENDED	AUGUST 31	NOVEMBER 30	FEBRUARY 28	MAY 31
Sales	\$ 1,085,820	\$ 907,792	\$ 1,141,585	\$1,279,635
Gross Profit	\$ 664,955	\$ 583,890	\$ 741,448	\$ 768,077
Net Income	\$ 162,795	\$ 35,551	\$ 137,669	\$ (87,210)
Net Income Per Share	\$0.02	\$0.01	\$0.02	\$(0.01)
Cash Dividends Per Share	-	-	-	-
Market Price of Common Stock (1)				
Low	\$2.66*	\$2.86*	\$2.25	\$2.38*
High	\$2.70*	\$2.86*	\$2.78	\$2.78*

* Share prices from this period have been converted from the original trading values in Canadian Dollars, at the rate of \$0.76/CDN\$1.00

COMMON STOCK INFORMATION AND DIVIDEND POLICY

As of August 1, 1996, there were 6,981,889 shares of Common Stock outstanding held by approximately 110 holders of record. The number of holders does not include individual participants in security position listings.

In June 1994, the Company paid its only cash dividend, which dividend equaled CDN \$0.02 per share. The Company's present policy is to retain earnings to finance the Company's business. Any future dividends will be dependent upon the Company's financial condition, results of operations, current 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.

THE PROBLEM:

Grinding is the most precise of machining techniques, and the method most commonly used to produce parts with exacting tolerances, both in finish and geometry. Accurately balancing grinding wheels is critical to achieving the increasing demands placed on the grinding process today. Only a small amount of wheel imbalance will cause vibration in the rotating grinding machine, and damage the form and surface of a ground piece. Traditionally, balancing was time-consuming and imprecise.

SBS PRODUCTS

[LOGO]

THE SOLUTION:

The Schmitt SBS Dynamic Balance System consists of a computer control, sensor, spindle mounting adaptor and balance head. It was successfully designed to be an inexpensive yet highly accurate, permanent installation on grinding machines. Schmitt Industries, Inc. continues to introduce new products for the grinding machine industry. The SBS multichannel control units allow the SBS system to balance, monitor and report machine vibration levels for up to four grinders operating in a work group, or manufacturing cell.

[PICTURE]

The Easy to install SBS Dynamic Balance System accurately balances grinding machines in seconds.

[PICTURE]

THE PROBLEM:

Accurately measuring surface roughness is critical in a variety of industrial applications. Performance of precision components such as computer hard disks, silicon wafers, and flat panel electronic displays rely on control of surface roughness or smoothness. In much of today's world of manufacturing, measurement of distance and alignment in closely toleranced products is critical in obtaining required results. Traditionally, micro measurements have been time consuming and costly due to existing contact measurement technologies.

[Logo]

SMS PRODUCTS

THE SOLUTION:

Schmitt Measurement Systems, Inc. (SMS) operates three non-contact laser based technology businesses:

- 1) Light Scatter Measurement Laboratory which provides highly advanced, extremely precise measurement services to a wide variety of industrial and commercial businesses, utilizing advanced laser light scatter technology.
- 2) A series of laser based light scatter measurement products utilized to measure surface roughness of a variety of materials in industrial and commercial operations.
- 3) Laser alignment products which determine accurate angle and distance measurements for commercial aircraft, automotive, and other industrial applications.

[Photographs]

SMS Products perform precision measurement of surface, dimension, and alignment quickly and accurately.

[Photographs]

INDEPENDENT AUDITOR'S REPORT

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS
SCHMITT INDUSTRIES, INC.

We have audited the accompanying consolidated balance sheets of Schmitt Industries, Inc., and Subsidiary as of May 31, 1996 and 1995, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the fiscal years ended May 31, 1996, 1995, and 1994. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Schmitt Industries, Inc., and Subsidiary as of May 31, 1996 and 1995, and the results of their operations and cash flows for each of the three years ended May 31, 1996, 1995, and 1994, in conformity with generally accepted accounting principles.

/s/ Moss Adams LLP

Portland, Oregon
July 16, 1996

END USERS:

Allied Signal Aerospace Company
Alumax Mill Products
American Axle
American Koyo Bearing Mfg. Corp.
Amada Engineering & Services

SCHMITT WORLDWIDE
THE SBS WORLDWIDE CUSTOMER LIST

Barden Corporation
Black & Decker Corporation
Boeing Company
Briggs & Stratton
Caterpillar Incorporated
Chrysler Corporation
Cummins Engine Company
Daimler Benz
Daewoo International Corporation
Dana Corporation
Deere & Company
Diesel Technology Corporation
Dresser-Rand
Eaton Corporation
Electrolux Corporation
Emerson Power Transmission
FAG Bearing Ltd.
Federal Mogul Corporation
Ford Motor Company
General Electric Corporation
General Motors Corporation
Greenfield Industries
Harley-Davidson Motor Company
Hamilton Standard
INA Bearing Corporation
Milwaukee Electric Tool
Mitsubishi Motor Company Ltd.
Navistar International transportation
Nissan Motors Ltd.
Norton Company
Parker Hannifin Corporation
Pfauter-Maag Cutting Tool
Pratt & Whitney
Reliance Electric Company
Rexnord Corporation
Robert Bosch Corporation
Siemens Automotive
SKF Bearing Industries
Stanley Works
Sumitomo Heavy Industries
Texas Instruments
The Timken Company
The Torrington Company
TRW Automotive Components
University of Connecticut Grinding Research Center
Westinghouse Electric Corporation
Weyburn-Bartel

AVAILABLE FROM MACHINE TOOL BUILDERS:

ANCA USA, Inc.
Bryant Grinder Corporation
Blohm, GMBH
Capco Machinery
Cincinnati Milacron
Elb America, Inc.
Gleason Works
Goldcrown Machinery
K.O. Lee
Koyo Machine
Landis Grinding Machines, Landis Lund
Mattison Machine
Mitsubishi Machine Tool
Normac Incorporated
Okamoto
Okuma
Royal Master Grinders
S.E. Huffman
Shigiya Machinery Works
Shanghai Machine Tool Works, SMTW/Ecotech
TOS Hostivar, TOS Holice
Toyoda Machinery USA, Toyoda Machinery, Ltd.

Unison Corporation
United Grinding Technologies - Korber Group
Blohm
Studer
Jones & Shipman
Weldon Machine Tool

AVAILABLE FROM REBUILDERS:

Abbott Machine
Airtronics
C&B Machinery
Centerless Rebuilders
Cincinnati Milacron
Dayton Machine Tool
Drake Manufacturing Services
Goldcrown Machinery
Grinders Clearinghouse
Toyoda/Grinders for Industry
Inter-Motion
Machine Tool Specialists
Vermont Rebuilders
Wyandotte Machine

AVAILABLE IN ASIA:

Kanetec Ltd. - Japan
Ecotech, Shanghai - China
Power-EMI - Korea

SUBSIDIARIES OF SCHMITT INDUSTRIES, INC.
AS OF MAY 31, 1996

SUBSIDIARY	STATE OF INCORPORATION OR COUNTRY IN WHICH ORGANIZED
Schmitt Measurement Systems, Inc.	Montana

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM SCHMITT INDUSTRIES, INC. INDEPENDENT AUDITORS' REPORT AND CONSOLIDATED FINANCIAL STATEMENTS MAY 31, 1996, 1995 AND 1994 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

YEAR		
	MAY-31-1996	
	JUN-01-1995	
	MAY-31-1996	
		508,240
		145,600
		1,411,805
		0
		1,781,331
	4,456,622	1,794,221
		312,189
		6,011,047
	924,536	
		174,532
	0	
		0
		4,098,512
		788,360
6,011,047		
		7,080,128
	7,080,128	
		2,547,054
		3,023,916
		17,237
		0
	45,130	
	1,446,791	
		299,538
1,509,158		
		0
		0
		0
		1,217,253
		.16
		.16