SCHMITT INDUSTRIES INC
Form 10-Q
October 15, 2018
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: August 31, 2018

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from: __________ To: __________

Commission File Number: 000-23996

SCHMITT INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

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

2765 NW Nicolai Street, Portland, Oregon 97210-1818

(Address of principal executive offices) (Zip Code)

(503) 227-7908

Indicate by check mark whether the registrant has (1) filed all reports required to be filed by Section 13 of 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

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

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

The number of shares of each class of common stock outstanding as of September 30, 2018

Common stock, no par value	3,994,545

Table of Contents

SCHMITT INDUSTRIES, INC.

INDEX TO FORM 10-Q

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

SCHMITT INDUSTRIES, INC.

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	August 31, 2018	May 31, 2018
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,742,786	$ 2,053,181
Restricted cash	58,040	58,352
Accounts receivable, net	1,871,737	2,047,032
Inventories	6,134,627	5,710,888
Prepaid expenses	119,883	148,924
Total current assets	9,927,073	10,018,377
Property and equipment, net	754,989	770,915
Other assets		
Intangible assets, net	470,622	496,768
TOTAL ASSETS	$ 11,152,684	$ 11,286,060
LIABILITIES & STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 1,008,211	$ 1,024,256
Accrued commissions	219,005	194,797
Accrued payroll liabilities	167,050	188,568
Other accrued liabilities	364,868	358,790
Income taxes payable	4,472	3,993
Total current liabilities	1,763,606	1,770,404
Stockholders equity		
Common stock, no par value, 20,000,000 shares authorized, 3,994,545 shares issued and outstanding at August 31, 2018 and May 31, 2018	13,091,249	13,085,652
Accumulated other comprehensive loss	(456,663)	(536,307)
Accumulated deficit	(3,245,508)	(3,033,689)

Total stockholders equity		9,389,078	9,515,656
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	11,152,684	$ 11,286,060

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

Table of Contents

SCHMITT INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

FOR THE THREE MONTHS ENDED AUGUST 31, 2018 AND 2017

(UNAUDITED)

	Three Months Ended August 31, 2018	2017
Net sales	$ 3,440,453	$ 3,083,648
Cost of sales	2,100,655	1,684,129
Gross profit	1,339,798	1,399,519
Operating expenses:		
General, administration and sales	1,405,363	1,468,344
Research and development	48,237	76,457
Total operating expenses	1,453,600	1,544,801
Operating loss	(113,802)	(145,282)
Other income (expense), net	(91,651)	17,543
Loss before income taxes	(205,453)	(127,739)
Provision for income taxes	6,366	6,359
Net loss	$ (211,819)	$ (134,098)
Net loss per common share:		
Basic	$ (0.05)	$ (0.04)
Weighted average number of common shares, basic	3,994,545	2,995,910
Diluted	$ (0.05)	$ (0.04)
Weighted average number of common shares, diluted	3,994,545	2,995,910
Comprehensive loss		
Net loss	$ (211,819)	$ (134,098)
Foreign currency translation adjustment	79,644	(14,724)
Total comprehensive loss	$ (132,175)	$ (148,822)

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

Table of Contents

SCHMITT INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED AUGUST 31, 2018 AND 2017

(UNAUDITED)

	Three Months Ended August 31, 2018	Three Months Ended August 31, 2017
Cash flows relating to operating activities		
Net loss	$ (211,819)	$ (134,098)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	47,217	52,750
Stock based compensation	5,597	21,367
(Increase) decrease in:		
Accounts receivable	164,312	258,280
Inventories	(434,075)	(339,884)
Prepaid expenses	28,447	(14,150)
Income taxes receivable	0	4,228
Increase (decrease) in:		
Accounts payable	(14,346)	(45,308)
Accrued liabilities and customer deposits	11,722	(118,566)
Income taxes payable	479	0
Net cash used in operating activities	(402,466)	(315,381)
Cash flows relating to investing activities		
Purchases of property and equipment	(5,250)	(7,578)
Net cash used in investing activities	(5,250)	(7,578)
Effect of foreign exchange translation on cash	97,009	(15,285)
Decrease in cash, cash equivalents and restricted cash	(310,707)	(338,244)
Cash, cash equivalents and restricted cash, beginning of period	2,111,533	867,607
Cash, cash equivalents and restricted cash, end of period	$ 1,800,826	$ 529,363
Supplemental disclosure of cash flow information		
Cash paid during the period for income taxes	$ 5,887	$ 2,131
Cash paid during the period for interest	$ 263	$ 413

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

Table of Contents

SCHMITT INDUSTRIES, INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

FOR THE THREE MONTHS ENDED AUGUST 31, 2018

(UNAUDITED)

	Shares	Amount	Accumulated other comprehensive loss	Accumulated deficit	Total
Balance, May 31, 2018	3,994,545	$ 13,085,652	$ (536,307)	$ (3,033,689)	$ 9,515,656
Stock-based compensation	0	5,597	0	0	5,597
Net loss	0	0	0	(211,819)	(211,819)
Other comprehensive loss	0	0	79,644	0	79,644
Balance, August 31, 2018	3,994,545	$ 13,091,249	$ (456,663)	$ (3,245,508)	$ 9,389,078

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

Table of Contents

SCHMITT INDUSTRIES, INC.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

NOTE 1:

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial information included herein has been prepared by Schmitt Industries, Inc. (the Company or Schmitt) and its wholly owned subsidiaries. In the opinion of management, the accompanying unaudited Consolidated Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly its financial position as of August 31, 2018 and its results of operations and its cash flows for the periods presented. The consolidated balance sheet at May 31, 2018 has been derived from the Annual Report on Form 10-K for the fiscal year ended May 31, 2018. The accompanying unaudited financial statements and related notes should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended May 31, 2018. Operating results for the interim periods presented are not necessarily indicative of the results that may be experienced for the fiscal year ending May 31, 2019.

Revenue Recognition

On June 1, 2018, the Company adopted Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606) using the modified retrospective approach. The adoption of this standard did not have a material impact on the Company s consolidated financial statements or related disclosures.

The Company determines the amount of revenue it recognizes associated with the transfer of each product or service using the five-step model provided by Topic 606. For sales of products or delivery of monitoring services to all customers, including manufacturing representatives, distributors or their third-party customers, each transaction is evaluated to determine whether there is approval and commitment from both the Company and the customer for the transaction; whether the rights of each party are specifically identified; whether the transaction has commercial substance; whether collectability from the customer is probable at the inception of the contract and whether the transaction amount is defined. If a transaction to sell products or provide monitoring services meets all of the above criteria, revenue is recognized for the sales of product at the time of shipment or for monitoring services at the completion of the month in which monitoring services are provided.

The Company incurs commissions associated with the sales of products, which are accrued and expensed at the time the product is shipped. These amounts are recorded within general, administration and sales expense.

The Company also incurs costs related to shipping and handling of its products, the costs of which are expensed as incurred as a component of cost of sales. Shipping and handling fees billed to customers are recognized at the time of shipment as a component of net sales.

Financial Instruments

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

Restricted Cash

Restricted cash consists of an amount received from a customer in December 2017 as part of an on-going contract. The services being provided under this contract are expected to be completed by December 2018, at which time the restrictions on this payment will lapse.

The following table provides a reconciliation of cash and cash equivalents and restricted cash as reported within the Consolidated Balance Sheets as of August 31, 2018 and May 31, 2018 to the sum of the same such amounts as shown in the Consolidated Statement of Cash Flows for the three months ended August 31, 2018:

	August 31, 2018	May 31, 2018
Cash and cash equivalents	$ 1,742,786	$ 2,053,181
Restricted cash	58,040	58,352
Total cash, cash equivalents, and restricted cash shown in the Consolidated Statement of Cash Flows	$ 1,800,826	$ 2,111,533

Page 7

Table of Contents

Accounts Receivable

The Company maintains credit limits for all customers based upon several factors, including but not limited to financial condition and stability, payment history, published credit reports and use of credit references. Management performs various analyses to evaluate accounts receivable balances to ensure recorded amounts reflect estimated net realizable value. This review includes using accounts receivable agings, other operating trends and relevant business conditions, including general economic factors, as they relate to each of the Company s domestic and international customers. If these analyses lead management to the conclusion that potential significant accounts are uncollectible, a reserve is provided. The allowance for doubtful accounts was $94,756 and $95,207 as of August 31, 2018 and May 31, 2018, respectively.

Inventories

Inventories are valued at the lower of cost or net realizable value with cost determined on the average cost basis. Costs included in inventories consist of materials, labor and manufacturing overhead, which are related to the purchase or production of inventories. Write-downs, when required, are made to reduce excess inventories to their net realizable values. Such estimates are based on assumptions regarding future demand and market conditions. If actual conditions become less favorable than the assumptions used, an additional inventory write-down may be required. As of August 31, 2018 and May 31, 2018, inventories consisted of:

	August 31, 2018	May 31, 2018
Raw materials	$ 2,806,360	$ 2,796,691
Work-in-process	1,294,974	1,009,424
Finished goods	2,033,293	1,904,773
	$ 6,134,627	$ 5,710,888

Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over estimated useful lives of three to seven years for furniture, fixtures and equipment; three years for vehicles; and twenty-five years for buildings and improvements. As of August 31, 2018 and May 31, 2018, property and equipment consisted of:

	August 31, 2018	May 31, 2018
Land	$ 299,000	$ 299,000
Buildings and improvements	1,814,524	1,814,524
Furniture, fixtures and equipment	1,257,518	1,252,598
Vehicles	44,704	44,704
	3,415,746	3,410,826
Less accumulated depreciation	(2,660,757)	(2,639,911)
	$ 754,989	$ 770,915

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for most leases previously classified as operating leases. The ASU is required to be applied using a modified retrospective approach at the beginning of the earliest period presented, with optional practical expedients. The FASB recently proposed an optional transition alternative, which would allow for application of the guidance at the beginning of the period in which it is adopted, rather than at the beginning of the earliest comparative period presented. The Company will adopt the new standard on June 1, 2019.

Table of Contents

The Company is currently evaluating the impact of this guidance, including reviewing the standard s provisions and gathering and analyzing data to support further evaluation of all real estate and non-real estate leases. The Company is also evaluating the impact of the accounting standard on the Company s financial statement disclosures, systems, processes and controls.

NOTE 2:

STOCK OPTIONS AND STOCK-BASED COMPENSATION

Stock-based compensation includes expense charges for all stock-based awards to employees and directors granted under the Company s stock option plan. Stock-based compensation recognized during the period is based on the portion of the grant date fair value of the stock-based award that will vest during the period, adjusted for expected forfeitures. Compensation cost for all stock-based awards is recognized using the straight-line method. The Company uses the Black-Scholes option pricing model as its method of valuation for stock-based awards. The Black-Scholes option pricing model requires the input of highly subjective assumptions, and other reasonable assumptions could provide differing results. These variables include, but are not limited to:

Risk-Free Interest Rate. The Company bases the risk-free interest rate on the implied yield currently available on U.S. Treasury issues with an equivalent remaining term approximately equal to the expected life of the award.

Expected Life. The expected life of awards granted represents the period of time that they are expected to be outstanding. The Company determines the expected life based on historical experience with similar awards, giving consideration to the contractual terms, vesting schedules and pre-vesting and post-vesting forfeitures.

Expected Volatility. The Company estimates the volatility of its common stock at the date of grant based on the historical volatility of its common stock. The volatility factor the Company uses is based on its historical stock prices over the most recent period commensurate with the estimated expected life of the award. These historical periods may exclude portions of time when unusual transactions occurred.

Expected Dividend Yield. The Company does not anticipate paying any cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield of 0.

Expected Forfeitures. The Company uses relevant historical data to estimate pre-vesting option forfeitures. The Company records stock-based compensation only for those awards that are expected to vest.

To determine stock-based compensation expense recognized for those options granted during the three months ended August 31, 2018, the Company has computed the value of all stock options granted using the Black-Scholes option pricing model as prescribed by ASC Topic 718 using the following assumptions:

	Three Months Ended August 31, 2018
Risk-free interest rate	3.1%
Expected life	6.0 years
Expected volatility	46.3%

At August 31, 2018, the Company had a total of 329,999 outstanding stock options (279,164 vested and exercisable and 50,835 non-vested) with a weighted average exercise price of $2.37. The Company estimates that $23,916 will be recorded as additional stock-based compensation expense over a weighted-average period of 1.5 years for all options that were outstanding as of August 31, 2018, but which were not yet vested.

Table of Contents

Outstanding Options			Exercisable Options	
Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (yrs)	Number of Shares	Weighted Average Exercise Price
167,499	$1.70	8.5	131,664	$1.70
30,000	2.49	7.4	15,000	2.53
77,500	2.85	5.6	77,500	2.85
55,000	3.65	2.8	55,000	3.65
329,999	2.37	6.7	279,164	2.45

Options granted, exercised, and forfeited or canceled under the Company s stock option plan during the three months ended August 31, 2018 are summarized as follows:

	Three Months Ended August 31, 2018	
	Number of Shares	Weighted Average Exercise Price
Options outstanding - beginning of period	318,332	$ 2.36
Options granted	15,000	2.45
Options exercised	0	0
Options forfeited/canceled	(3,333)	1.70
Options outstanding - end of period	329,999	2.37

NOTE 3:

EPS RECONCILIATION

	Three Months Ended August 31,	
	2018	2017
Weighted average shares (basic)	3,994,545	2,995,910
Effect of dilutive stock options	0	0
Weighted average shares (diluted)	3,994,545	2,995,910

Basic earnings (loss) per share is computed using the weighted average number of common shares outstanding. Diluted earnings (loss) per share is computed using the weighted average number of common shares outstanding, adjusted for dilutive incremental shares attributed to outstanding options to purchase common stock. Common stock equivalents for stock options are computed using the treasury stock method. In periods in which a net loss is incurred, no common stock equivalents are included since they are antidilutive and as such all stock options outstanding are excluded from the computation of diluted net loss in those periods.

NOTE 4:

INCOME TAXES

The Company accounts for income taxes using the asset and liability method. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of assets and liabilities. Deferred tax assets are reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be

Table of Contents

realized. Management continues to review the level of the valuation allowance on a quarterly basis. There can be no assurance that the Company s future operations will produce sufficient earnings to allow for the deferred tax asset to be fully utilized. The Company currently maintains a full valuation allowance against net deferred tax assets.

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

Other long-term liabilities related to tax contingencies were $0 as of both August 31, 2018 and May 31, 2018. Interest and penalties associated with uncertain tax positions are recognized as components of the Provision for income taxes. The liability for payment of interest and penalties was $0 as of August 31, 2018 and May 31, 2018.

Several tax years are subject to examination by major tax jurisdictions. In the United States, federal tax years ended May 31, 2015 and after are subject to examination. In the United Kingdom, tax years ended May 31, 2013 and after are subject to examination.

Effective Tax Rate

The effective tax rate on consolidated net loss was 3.1% for the three months ended August 31, 2018. The effective tax rate on consolidated net loss differs from the federal statutory tax rate primarily due to changes in the deferred tax valuation allowance and certain expenses not being deductible for income tax reporting purposes. Management believes the effective tax rate for Fiscal 2019 will be approximately 44.9% due to the items noted above.

NOTE 5:

SEGMENTS OF BUSINESS

The Company has two reportable business segments: dynamic balancing and process control systems for the machine tool industry (Balancer) and laser-based test and measurement systems and ultrasonic measurement products (Measurement). The Company operates in three principal geographic markets: North America, Europe and Asia.

Segment Information

	Three Months Ended August 31,			
	2018		2017	
	Balancer	Measurement	Balancer	Measurement
Gross sales	$ 2,591,304	$ 1,246,121	$ 2,445,486	$ 1,013,251
Intercompany sales	(396,972)	0	(375,089)	0
Net sales	$ 2,194,332	$ 1,246,121	$ 2,070,397	$ 1,013,251

Operating income (loss)	$ (262,501)	$ 148,699	$ (211,780)	$ 66,498
Depreciation expense	$ 12,072	$ 8,999	$ 16,982	$ 9,622
Amortization expense	$ 0	$ 26,146	$ 0	$ 26,146
Capital expenditures	$ 5,250	$ 0	$ 7,578	$ 0

Table of Contents

Geographic Information Net Sales by Geographic Area

	Three Months Ended August 31, 2018	2017
North America	$ 2,200,201	$ 1,791,101
Europe	373,463	517,863
Asia	824,776	749,422
Other markets	42,013	25,262
Total net sales	$ 3,440,453	$ 3,083,648

	Three Months Ended August 31, 2018		2017	
	United States	Europe	United States	Europe
Operating income (loss)	$ (131,190)	$ 17,388	$ (215,465)	$ 70,183
Depreciation expense	$ 21,071	$ 0	$ 26,604	$ 0
Amortization expense	$ 26,146	$ 0	$ 26,146	$ 0
Capital expenditures	$ 5,250	$ 0	$ 7,578	$ 0

Note Europe is defined as the European subsidiary, Schmitt Europe Ltd.

Segment and Geographic Assets

	August 31, 2018	May 31, 2018
Segment assets to total assets		
Balancer	$ 6,433,148	$ 6,461,974
Measurement	2,918,710	2,712,553
Corporate assets	1,800,826	2,111,533
Total assets	$ 11,152,684	$ 11,286,060
Geographic assets to long-lived assets		
United States	$ 754,989	$ 770,915
Europe	0	0
Total long-lived assets	$ 754,989	$ 770,915
Geographic assets to total assets		

United States	$ 10,070,342	$ 10,110,683
Europe	1,082,342	1,175,377
Total assets	$ 11,152,684	$ 11,286,060

Page 12

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Forward-Looking Statements

This Quarterly Report filed with the SEC on Form 10-Q (the Report), including Management s Discussion and Analysis of Financial Condition and Results of Operations in this Item 2, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 regarding future events and the future results of Schmitt Industries, Inc. and its consolidated subsidiaries (the Company) that are based on management s current expectations, estimates, projections and assumptions about the Company s business. Words such as expects, anticipates, intends, plans, believes, sees, estimates and variations of such words and similar expressions are i to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors, including, but not limited to, those discussed in the Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Report as well as those discussed from time to time in the Company s other Securities and Exchange Commission filings and reports. In addition, such statements could be affected by general industry and market conditions. Such forward-looking statements speak only as of the date of this Report or, in the case of any document incorporated by reference, the date of that document, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Report. If we update or correct one or more forward-looking statements, investors and others should not conclude that we will make additional updates or corrections with respect to other forward-looking statements.

RESULTS OF OPERATIONS

Overview

Schmitt Industries, Inc. (the Company), an Oregon corporation, designs, manufactures and sells high precision test and measurement products for two main business segments: the Balancer segment and the Measurement segment. For the Balancer segment, the Company designs, manufactures and sells computer-controlled vibration detection, balancing and process control systems for the worldwide machine tool industry, particularly for grinding machines. The Company also provides sales and service for Europe and Asia through its wholly owned subsidiary, Schmitt Europe Limited (SEL), located in Coventry, England and through its sales representative office located in Shanghai, China. For the Measurement segment, the Company designs, manufacturers and sells products in two core product lines: the Acuity® product line, which includes laser and white light sensor distance, measurement and dimensional sizing products; and the Xact® product line, which includes remote tank monitoring products that measure the fill levels of tanks holding propane, diesel and other tank-based liquids and the related monitoring services, which includes transmission of fill data from the tanks via satellite to a secure web site for display. The accompanying unaudited financial information should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended May 31, 2018.

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

Highlights of the Quarter Ended August 31, 2018

- Balancer segment sales increased $123,935, or 6.0%, to $2,194,332 for the three months ended August 31, 2018 from $2,070,397 for the three months ended August 31, 2017

Measurement segment sales increased $232,870, or 23.0%, to $1,246,121 for the three months ended August 31, 2018 from $1,013,251 for the three months ended August 31, 2017;

Operating expenses decreased $91,201, or 5.9%, to $1,453,600 for the three months ended August 31, 2018 from $1,544,801 for the three months ended August 31, 2017.

Critical Accounting Policies

There were no material changes in our critical accounting policies as disclosed in our Annual Report on Form 10-K for the year ended May 31, 2018, other than the adoption of Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606) which the Company adopted on June 1, 2018. See Note 1 Revenue Recognition for further discussion and disclosures related to the adoption of ASU No. 2014-09.

Table of Contents

Discussion of Operating Results

	Three Months Ended			
	August 31, 2018		August 31, 2017	
Balancer sales	$ 2,194,332	63.8%	$ 2,070,397	67.1%
Measurement sales	1,246,121	36.2%	1,013,251	32.9%
Total net sales	3,440,453	100.0%	3,083,648	100.0%
Cost of sales	2,100,655	61.1%	1,684,129	54.6%
Gross profit	1,339,798	38.9%	1,399,519	45.4%
Operating expenses:				
General, administration and sales	1,405,363	40.8%	1,468,344	47.6%
Research and development	48,237	1.4%	76,457	2.5%
Total operating expenses	1,453,600	42.3%	1,544,801	50.1%
Operating loss	(113,802)		(145,282)	
Other income (expnese), net	(91,651)		17,543	
Loss before income taxes	(205,453)		(127,739)	
Provision for income taxes	6,366		6,359	
Net loss	$ (211,819)		$ (134,098)	

Net Sales Total net sales increased $356,805, or 11.6%, to $3,440,453 for the three months ended August 31, 2018 from $3,083,648 for the three months ended August 31, 2017.

The Balancer segment focuses its sales efforts on end-users, rebuilders and original equipment manufacturers of grinding machines within the worldwide machine tool industry, with our primary target geographic markets being North America, Asia, and Europe. Balancer segment sales increased $123,935, or 6.0%, to $2,194,332 for the three months ended August 31, 2018 as compared to $2,070,397 for the three months ended August 31, 2017. The increase was attributed to stronger sales in both North America and Asia, offset by lighter sales in the European market. Sales by geographic markets for the Balancer segment for the three months ended August 31, 2018 and 2017 were as follows:

	Three Months Ended August 31,			
	2018	2017	Variance	
North America	$ 990,881	$ 850,142	$ 140,739	16.6%
Asia	789,586	746,797	42,789	5.7%
Europe	371,852	448,196	(76,344)	(17.0%)
Other	42,013	25,262	16,751	66.3%

Total Balancer segment sales	$ 2,194,332	$ 2,070,397	$ 123,935	6.0%

The levels of demand for our Balancer products in any of these geographic markets cannot be forecasted with any certainty given current economic trends and the historical volatility experienced in this market.

Table of Contents

The Measurement segment includes two main product lines: the Acuity® product line, which includes laser-based distance measurement and dimensional sizing laser sensors; and the Xact® product line, which includes ultrasonic-based remote tank monitoring products and related monitoring revenues. Measurement sales increased $232,870, or 23.0%, to $1,246,121 for the three months ended August 31, 2018 as compared to $1,013,251 for the three months ended August 31, 2017. This increase is primarily driven by stronger product sales and increases in monitoring revenues associated with the Xact product line. Sales by product line for the Measurement segment for first quarter of Fiscal 2019 as compared to the first quarter of Fiscal 2018 were as follows:

	Three Months Ended August 31,			
	2018	2017	Variance	
Acuity	$ 420,372	$ 582,635	$ (162,263)	(27.8%)
Xact - product sales	508,826	148,019	360,807	243.8%
Xact - monitoring revenues	316,173	274,957	41,216	15.0%
Lasercheck	0	7,640	(7,640)	(100.0%)
SMS	750	0	750	
Total Measurement segment sales	$ 1,246,121	$ 1,013,251	$ 232,870	23.0%

Gross margin Gross margin for the three months ended August 31, 2018 decreased to 38.9% as compared to 45.4% for the three months ended August 31, 2017. The variances in gross margin between the periods presented were primarily influenced by shifts in the product sales mix between higher margin products in Acuity and SBS product lines and lower margin products in the Xact product line and an increase in product costs between the first quarter of Fiscal 2018 and the first quarter of Fiscal 2019.

Operating expenses Operating expenses decreased $91,201, or 5.9%, to $1,453,600 for the three months ended August 31, 2018 from $1,544,801 for the three months ended August 31, 2017. The decrease in operating expenses was driven, in part, by the following:

- Decrease in administrative wages and related payroll expenses in the amount of $112,431, or 28.5%, related to the realigning of the management team which occurred in the second half of Fiscal 2018;

- Decrease in research and development expense in the amount of $28,220, or 36.9%, related to the timing of certain product development initiatives;

- Decrease in commissions expense in the amount of $32,090, or 12.9%, due to restructuring of the Company s sales commissions programs; and

- Decrease in other administrative expenses in the amount of $52,766, or 26.0%, related to controlled expense initiatives put in place in the second half of Fiscal 2018.

These decreases were offset by:

Increase in legal, accounting and other professional expenses in the amount of $162,155, or 68.8%. The increase is primarily related to additional legal and other professional expenses in the amount of $132,050 incurred during the first quarter of Fiscal 2019 that were not incurred in the same period in the prior year.

Other income (expense) Other income (expense) consists of foreign currency exchange gain (loss), interest income (expense) and other income (expense). Foreign currency exchange gains (losses) were $(98,872) and $17,441 for the three months ended August 31, 2018 and 2017, respectively. The shifts in the foreign currency exchange are related to significant fluctuations of foreign currencies against the U.S. dollar during the current period of Fiscal 2019. Interest income (expense), net was $7,207 and $97 for the three months ended August 31, 2018 and 2017, respectively. Other income (expense) was $14 for the first quarter of Fiscal 2019 as compared to $5 for the same period in the prior year.

Income taxes The Company s effective tax rate on consolidated net loss was (3.1)% for the three months ended August 31, 2018. The effective tax rate on consolidated net loss differs from the federal statutory tax rate primarily due to changes in the deferred tax valuation allowance and certain expenses not being deductible for income tax reporting purposes. Management believes the effective tax rate for Fiscal 2019 will be approximately 44.9% due to the items noted above.

Net loss Net loss was $211,819, or $(0.05) per fully diluted share, for the three months ended August 31, 2018 as compared to net loss of $134,098, or $(0.04) per fully diluted share, for the three months ended August 31, 2017.

LIQUIDITY AND CAPITAL RESOURCES

The Company s working capital decreased $84,506 to $8,163,467 as of August 31, 2018 as compared to $8,247,973 as of May 31, 2017.

Cash, cash equivalents and restricted cash decreased $310,707 to $1,800,826 as of August 31, 2018 from $2,111,533 as of May 31, 2018. Cash used in operating activities totaled $402,466 for the three months ended August 31, 2018 as compared to cash used in operating activities of $315,381 for the three months ended August 31, 2017. The net loss of $211,819 along with

Table of Contents

increases in inventories, offset by decreases in accounts receivable primarily impacted the total cash used in operating activities for the three months ended August 31, 2018. The net loss of $134,098 and changes in accounts receivable, inventories and accounts payable and accrued liabilities had the largest impact on the cash used in operating activities for the three month period ended August 31, 2017.

At August 31, 2018, the Company had accounts receivable of $1,871,737 as compared to $2,047,032 at May 31, 2018. The decrease in accounts receivable of $175,295 was due to timing of receipts. Inventories increased $423,739 to $6,134,627 as of August 31, 2018 as compared to $5,710,888 at May 31, 2018, which is due primarily to the targeted increases in inventory levels within our SBS and Xact product lines. At August 31, 2018, total current liabilities decreased $6,798 to $1,763,606, as compared to $1,770,404 at May 31, 2018. The decrease in current liabilities is primarily due to the timing of payments to our" width="1%" style="border-bottom: #cceeff;">

1.03

Pro forma

(0.06

)

1.03

Diluted earnings (loss) per share:

As reported

(0.05

)

0.45

Pro forma

(0.05

)

0.45

Discontinued Operations

During the first quarter ended December 31, 2004, we committed to a plan to sell our ATM business. On February 19, 2005, we entered into an asset purchase agreement with NCR Texas LLC for the sale of our ATM business. For additional information, see aforementioned discussion in “Proposed Sale of ATM Business”. We have classified the ATM business has been classified as a discontinued operation since October 1, 2004, including for the comparative period in the prior year. This division manufactures and sells automated teller machines primarily in the United States. The results of this operation are segregated on the accompanying statements of operations as income or loss from discontinued operations and reflected as Assets and Liabilities Held for Sale on the accompanying balance sheets.

We recorded a net loss of $(1,155,564) and net income of $17,970,505 for the quarters ended December 31, 2004 and 2003, respectively. The discontinued operation recorded income of $132,514 for the quarter ended December 31, 2004 and income of $25,415 for the quarter ended December 31, 2003. The sale of this division is expected to be consummated sometime during the fourth calendar quarter of 2005.

An analysis of the assets and liabilities held for sale and revenues is as follows:

Assets held for sale:		
Trade accounts receivable (net of allowances for bad debt)	$	2,769,028
Inventories (net of reserves for obsolescence)		3,820,458
Prepaid expenses and other assets		197,724
Property, plant and equipment, at cost net of depreciation		218,204
Other assets		27,297
Assets held for sale	$	7,032,711
Liabilities held for sale:		
Accounts payable	$	1,866,688
Other accrued expenses		826,250
Liabilities held for sale	$	2,692,938

Revenues for the three months ended December 31, 2004 and 2003 for the discontinued operations were $7,653,835 and $4,617,908, respectively.

2. Long-Term Debt

On November 26, 2004, we completed a $3,350,000 financing transaction (the “Additional Financing”) with Laurus pursuant to that certain Securities Purchase Agreement by and between the Company and Laurus, dated as of November 26, 2004 (the “2004 SPA”). The Additional Financing was comprised of (i) a three-year convertible note issued to Laurus in the amount of $1,500,000, which bears interest at a rate of 14% and is convertible into our common stock at a conversion price of $3.00 per share (the “$1,500,000 Note”), (ii) a one-year convertible note in the amount of $600,000 which bears interest at a rate of 10% and is convertible into our common stock at a conversion price of $0.30 per share (the “$600,000 Note”), (iii) a one-year convertible note of our subsidiary, Tidel Engineering, L.P., in the amount of $1,250,000, which is a revolving working capital facility for the purpose of financing purchase orders of our subsidiary, Tidel Engineering, L.P., (the “Purchase Order Note”), which bears interest at a rate of 14% and is convertible into our common stock at a price of $3.00 per share and (iv) our issuance to Laurus of 1,251,000 shares of common stock, or approximately 7% of the total shares outstanding, (the “2003 Fee Shares”) in satisfaction of fees totaling $375,300 incurred in connection with the convertible term notes issued in the Financing discussed above. As a result of the sale of the 2003 Fee Shares, we recorded an additional charge in fiscal 2004 of $638,010 based on the market value of the stock on November 26, 2004. We also increased the principal balance of the original note by $292,987, of which $226,312 bears interest at the default rate of 18%. This amount represents interest accrued but not paid to Laurus as of August 1, 2004. In addition, Laurus received warrants to purchase 500,000 shares of our common stock at an exercise price of $0.30 per share. The proceeds of the Additional Financing were allocated to the notes based on the relative fair value of the notes and the warrants, with the value of the warrants resulting in a discount against the notes. In addition, the conversion terms of the $600,000 Note resulted in a beneficial conversion feature, further discounting the carrying value of the notes. As a result, we will record additional interest charges related to these discounts totaling $840,000 over the terms of the notes. Laurus was also granted registration rights in connection with the 2003 Fee Shares and other shares issuable pursuant to the Additional Financing. The obligations pursuant to the Additional Financing are secured by all of our assets and are guaranteed by our subsidiaries. Net proceeds from the Additional Financing in the amount of $3,232,750 were primarily used for (i) general working capital payments made directly to vendors, (ii) past due interest on Laurus’s $6,450,000 convertible note due pursuant to the Financing and (iii) the establishment of an escrow for future principal and interest payments due pursuant to the Additional Financing.

THE NOTES AND WARRANTS ISSUED IN THE FINANCING AND THE ADDITIONAL FINANCING ARE CONVERTIBLE INTO AN AGGREGATE OF 28,226,625 SHARES OF OUR COMMON STOCK AND, WHEN COUPLED WITH THE 2003 FEE SHARES, REPRESENT APPROXIMATELY 60% OF OUR OUTSTANDING COMMON STOCK SUBJECT TO ADJUSTMENT AS PROVIDED IN THE TRANSACTION DOCUMENTS. IF THESE NOTES AND WARRANTS WERE COMPLETELY CONVERTED TO COMMON STOCK BY LAURUS, THEN THE OTHER EXISTING SHAREHOLDERS’ OWNERSHIP IN THE COMPANY WOULD BE SIGNIFICANTLY DILUTED TO APPROXIMATELY 40% OF THEIR PRESENT OWNERSHIP POSITION.

In connection with the Financing, Laurus required that we covenant to become current in our filings with the Securities and Exchange Commission according to a predetermined schedule. Effective November 26, 2004, the Additional Financing documents require, among other things, that we provide evidence of filing to Laurus of our fiscal 2003, fiscal 2004 and year-to-date interim 2005 filings with the Securities and Exchange Commission on or before July 31, 2005. The 10-K for the fiscal year ended September 30, 2002 (the “2002 10-K”) was filed on February 1, 2005, in accordance with Additional Financing documents requirements. Fourteen (14) days following such time as we become current in our filings with the Securities and Exchange Commission, we must deliver to Laurus evidence of the listing of our common stock on the Nasdaq Over The Counter Bulletin Board (the “Listing Requirement”).

On February 4, 2005, we received a letter from the Securities and Exchange Commission stating that the Division of Corporate Finance of the SEC would not object to the Company filing a comprehensive annual report on Form 10-K which covers all of the periods during which it has been a delinquent filer, together with its filing all Forms 10-Q which are due for quarters subsequent to the latest fiscal year included in that comprehensive annual report. However, the SEC Letter also stated that, upon filing such a comprehensive Form 10-K, the Company would not be considered “current” for purposes of Regulation S, Rule 144 or filing on Forms S-8, and that the Company would not be eligible to use Forms S-2 or S-3 until a sufficient history of making timely filings is established. Laurus consented to the filing of such a comprehensive annual report in satisfaction of the Filing Requirements mandated on or before July 31, 2005. Laurus also consented to a modification of the requirement that a Registration Statement be filed within 20 days of satisfaction of the Filing Requirements to instead require that the Registration Statement be filed by September 20, 2006.

Pursuant to the terms of the Financing and the Additional Financing, an Event of Default occurs if, among other things, we do not complete our filings with the Securities and Exchange Commission on the timetable set forth in the Additional Financing documents, or we do not comply with the Listing Requirement or any other material covenant or other term or condition of the 2003 SPA, the 2004 SPA, the notes we issued to Laurus or any of the other documents related to the Financing or the Additional Financing. If there is an Event of Default, including any of the items specified above or in the transaction documents, Laurus may declare all unpaid sums of principal, interest and other fees due and payable within five (5) days after we receive a written notice from Laurus. If we cure the Event of Default within that five (5) day period, the Event of Default will no longer be considered to be occurring.

If we do not cure such Event of Default, Laurus shall have, among other things, the right to have two (2) of its designees appointed to our Board, and the interest rate of the notes shall be increased to the greater of 18% or the rate in effect at that time.

On November 26, 2004, in connection with the Additional Financing, we entered into an agreement with Laurus (the "Asset Sales Agreement") whereby we agreed to pay a fee in the amount of at least $2,000,000 (the "Reorganization Fee") to Laurus upon the occurrence of certain events as specified below and therein, which Reorganization Fee is secured by all of our assets, and is guaranteed by our subsidiaries. The Asset Sales Agreement provides that (i) once our obligations to Laurus have been paid in full (other than the Reorganization Fee), we shall be able to seek additional financing in the form of a non-convertible bank loan in an aggregate principal amount not to exceed $4,000,000, subject to Laurus's right of first refusal; (ii) the net proceeds of an asset sale to the party named therein shall be applied to our obligations to Laurus under the Financing and the Additional Financing, as described above (collectively, the "Obligations"), but not to the Reorganization Fee; and (iii) the proceeds of any of our subsequent sales of equity interests or assets or of our subsidiaries consummated on or before the fifth anniversary of the Assets Sales Agreement (each, a "Company Sale") shall be applied first to any remaining obligations, then paid to Laurus pursuant to an increasing percentage of at least 55.5% set forth therein, which amount shall be applied to the Reorganization Fee. Under this formula, the existing shareholders could receive less than 45% of the proceeds of any sale of our assets or equity interests, after payment of the Additional Financing and Reorganization Fee as defined. The Reorganization Fee shall be $2,000,000 at a minimum, but could equal a higher amount based upon a percentage of the proceeds of any company sale, as such term is defined in the Asset Sales Agreement. In the event that Laurus has not received the full amount of the Reorganization Fee on or before the fifth anniversary of the date of the Asset Sales Agreement, then we shall pay any remaining balance due on the Reorganization Fee to Laurus. We have recorded a $2,000,000 charge in the first quarter of fiscal 2005 to interest expense.

3. Earnings Per Share

Earnings per share data for all periods presented have been computed pursuant to SFAS No. 128, "Earnings Per Share" that requires a presentation of basic earnings per share (basic EPS) and diluted earnings per share (diluted EPS). Basic EPS excludes dilution and is determined by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that could occur if securities and other contracts to issue common stock were exercised or converted into common stock. As of December 31, 2004, we had outstanding options covering an aggregate of 796,000 shares of common stock, of which 731,000 shares were exercisable. We also had outstanding warrants covering an aggregate of 6,079,473 shares of common stock. Excluded from the computation of diluted EPS for the three months ended December 31, 2004 are options to purchase 976,000 shares to purchase common stock at a weighted average of $1.66 per share and 6,079,473 warrants, with a remaining exercise price ranging from $0.30 to $0.40, as they would be anti-dilutive. As of December 31, 2003, we had outstanding options covering an aggregate of 981,000 shares of common stock, of which 811,000 shares were exercisable. We also had outstanding warrants covering an aggregate of 6,379,473 shares of common stock. Excluded from the computation of diluted EPS for the three months ended December 31, 2004 are options to purchase 981,000 shares to purchase common stock at a weighted average of $1.64 per share and 6,079,473 warrants, with a remaining exercise price ranging from $0.30 to $11.17, as they would be anti-dilutive.

4. Shareholders' Equity

Existing shareholders' ownership in the Company will be significantly diluted due to outstanding warrants. The notes and warrants issued in the Financing and the Additional Financing are convertible into an aggregate of 28,226,625 shares of our common stock and, when coupled with the 2003 Fee Shares, represent approximately 60% of our outstanding common stock, subject to adjustment as provided in the transaction documents. If these notes and warrants were completely converted to common stock by Laurus, then the other existing shareholders' ownership in the Company would be significantly diluted to approximately 40% of their present ownership position.

During the quarter ended December 31, 2004, we issued issued 2,000,000 shares of our common stock related to the settlement of the class action litigation. In addition, we issued 1,251,000 shares of our common stock to Laurus (see Note 2, "Long-Term Debt") related to settlement of late filing penalties. As of September 30, 2004, we accrued

$1,564,490 for the settlement of the class action litigation and $638,010 for the settlement of the late filing penalties.

ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

You should read the following discussion and analysis together with our consolidated financial statements and notes thereto and the discussion "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Risk Factors" and "Forward-Looking Statements" included in our 2004 Annual Report on Form 10-K for the Fiscal Years Ended September 30, 2003 and September 30, 2004 (the "'03/'04 Annual Report"). The following information contains forward-looking statements, which are subject to risks and uncertainties. Should one or more of these risks or uncertainties materialize, actual results may differ from those expressed or implied by the forward-looking statements

11

General

During the past three years, we have experienced operating losses. Our liquidity has been negatively impacted by our inability to collect outstanding receivables and claims as a result of the bankruptcy of our former largest customer, JRA 222, Inc. d/b/a Credit Card Center ("CCC") the inability to collect outstanding accounts receivable from certain customers, under-absorbed fixed costs associated with the production facilities, and reduced sales of our products resulting from general difficulties in the ATM market. In order to meet our liquidity needs during the past three years, we have incurred a substantial amount of debt. This decline in financial condition is significant, and if the operating conditions do not improve there can be no assurance we will continue operations.

Critical Accounting Policies

This discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts. On an ongoing basis, we evaluate our estimates, including those related to bad debts, inventories, intangible assets, assets held for sale, long-lived assets, income taxes, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions and factors that we believe to be reasonable under the circumstances. Based on our ongoing review, we make adjustments we consider appropriate under the facts and circumstances. The accompanying condensed consolidated financial statements are prepared using the same critical accounting policies discussed in our '03/'04 Annual Report.

Results of Operations

Quarter Ended December 31, 2004 Compared to the Quarter Ended December 31, 2003

Our revenues from continuing operations were $6,512,542 for the three months ended December 31, 2004, representing an increase of $3,476,615, or 114%, from revenues of $3,035,927 in the same quarter of the prior year. This increase was primarily related to increased sales of our Sentinel products, as described more fully hereinafter in "Product Revenues".

We had a net loss from continuing operations of $(1,288,078) for the three months ended December 31, 2004, compared to income from continuing operations of $17,945,090 in the same quarter of the prior year. The decrease is mainly attributable to a gain on debt extinguishment incurred during the quarter ended December 31, 2003 of $18,823,000, partially offset by a $2,000,000 Reorganization Fee related to the Additional Financing that was charged to interest expense in the quarter ended December 31, 2004.

Operating Segments

We conduct business within one operating segment, principally in the United States.

Product Revenues

A breakdown of net sales by individual product line is provided in the following table, excluding discontinued operations:

	(Dollars in 000's) Three Months Ended December 31,			
	2004		2003	
CASH SECURITY BUSINESS	$	6,050	$	2,797
OTHER		463		239

	$	6,513	$	3,036

The Company's sales of Cash Security products vary with the timing of large orders and variances from quarter to quarter are not meaningful.

Gross Profit, Operating Expenses and Non-Operating Items

A comparison of certain operating information is provided in the following table:

	(Dollars in 000's) Three Months Ended December 31,			
		2004		2003
Gross profit	$	3,045	$	1,144
Selling, general and administrative		1,250		1,205
Depreciation and amortization		8		11
Operating income (loss)		1,787		(72)
Gain on extinguishment of debt		—		18,823
Interest expense, net		(3,075)		(806)
Income (loss) from continuing operations		(1,288)		17,945
Income from discontinued operations		132		26
Net Income (loss)	$	(1,156)	$	17,971

Revenues during the first quarter ended December 31, 2004 were $6,512,542, compared with $3,035,927 for the quarter ended December 31, 2003. The increase was primarily a result of sales of the Sentinel product. We sold 616 sentinel units during the first quarter of 2005, compared with 113 units in the first quarter of 2004. Of the 616 Sentinel units sold during the first quarter of 2005, 578 units were sold to a national convenience store operator. This accounted for approximately $4,707,000 of revenue from continuing operations, or 72% of revenue for the first quarter ended December 31, 2004.

Gross profit on product sales for the quarter ended December 31, 2004, increased $1,901,000 from the same quarter a year ago. Gross profit as a percentage of sales was 46.8 % in the quarter ended December 31, 2004, compared to only 37.7 % in the same quarter of the previous year. The improvement is directly related to the increase in the volume of Cash Security Products produced during the quarter ended December 31, 2004.

Selling, general and administrative expenses for the quarter ended December 31, 2004 increased only 3.6 % compared with the same quarter of the previous year despite increased sales for the period. The increase is generally attributable to additional costs associated with updating our filings with the SEC during quarter ended December 31, 2004.

Interest expense was $3,075,000 for the quarter ended December 31, 2004, compared to $805,515 for the quarter ended December 31, 2003. The net increase is primarily due to the Reorganization Fee (as hereinafter defined) and additional debt discount amortization incurred in connection with the Additional Financing (as hereinafter defined).

Income tax expense (benefit). In assessing the realizability of deferred tax asset, management considers whether it is more likely than not some portion or all of the deferred tax assets will be realized. We have established a valuation allowance for such deferred tax assets to the extent such amounts are not utilized to offset existing deferred tax liabilities reversing in the same periods.

Discontinued operations (net of tax). During the first quarter ended December 31, 2004, we committed to a plan to sell our ATM business. On February 19, 2005, we entered into an asset purchase agreement with NCR Texas LLC for the sale of our ATM business. For additional information, see aforementioned discussion in Note 1, "Proposed Sale of ATM Business" to the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2004 (this "Quarterly Report"). The ATM division has been classified as a discontinued operation since October 1, 2004, including the comparative period in the prior year. This division manufactures and sells automated teller machines primarily in the United States. The results of this operation are segregated on the accompanying statements of operations as income or loss from discontinued operations and reflected as Assets and Liabilities Held for Sale on the accompanying balance sheets.

The discontinued operation recorded income of $132,514 for the quarter ended December 31, 2004 and income of $25,415 for the quarter ended December 31, 2003. Such increase was primarily the result of an increase in parts sales and service. The sale of the ATM division pursuant to the Asset Purchase Agreement is expected to be consummated within the next twelve months, although there can be no assurance that such sale will be consummated in such time frame, if at all.

An analysis of the assets and liabilities held for sale and revenues is as follows:

Assets held for sale:		
Trade accounts receivable	$	2,769,028
Inventories		3,820,458
Prepaid expenses and other assets		197,724
Property, plant and equipment, at cost net of depreciation		218,204
Other assets		27,297
Assets held for sale	$	7,032,711
Liabilities held for sale:		
Accounts payable	$	1,866,688
Other accrued expenses		826,250
Liabilities held for sale	$	2,692,938

Revenues for the three months ended December 31, 2004 and 2003 for the discontinued operations were $7,653,835 and $4,617,908, respectively.

Liquidity and Capital Resources

General

During the past three years, we have experienced operating losses. Our liquidity has been negatively impacted by our inability to collect outstanding receivables and claims as a result of CCC's bankruptcy, the inability to collect outstanding receivables from certain customers, under-absorbed fixed costs associated with the production facilities, and reduced sales of our products resulting from general difficulties in the ATM market. In order to meet our liquidity needs during the past three years, we have incurred a substantial amount of debt.

	(Dollars in 000's)			
	December 31, 2004		September 30, 2004	
Cash	$	726	$	258
Working capital		4,143		1,824
Total assets		16,585		10,788
Total short-term notes payable and long-term debt, net of discount		3,528		212
Shareholders' equity		4,918		2,588

Cash used in continuing operations was $(1,339,992) for the three months ended December 31, 2004 compared to cash used in continuing operations of $(1,182,491) for the three months ended December 31, 2003. Cash used in operations is primarily attributable to increased sales of our TACC line.

Cash provided by financing activities was $2,649,869 for the three months ended December 31, 2004 compared to cash provided by financing activities of $884,235 for same period of 2003. The net increase resulted primarily from the proceeds from the Additional Financing.

After several months of unsuccessful efforts to remedy its financial difficulties, CCC filed for protection under Chapter 11 of the United States Bankruptcy Code on June 6, 2001. At that time, we had accounts and a note receivable due from CCC totaling approximately $27 million. The proceeding was subsequently converted to a Chapter 7 proceeding and a Trustee was appointed in April 2002. We have written off substantially all of the $24.1 million owed to us by CCC against the remaining balance of the note and trade accounts receivable, resulting in a $250,000 balance in accounts receivable as of December 31, 2004. Our management intends to continue monitoring this matter and to take all actions that it determines to be necessary based upon its findings. Our liquidity was negatively impacted by our inability to collect the outstanding receivables and claims from CCC.

Our ability to continue as a going concern is dependent on generating sufficient cash flows from operations for meeting our liquidity needs, servicing our debt requirements and meeting financial covenants. During the past four years and for the first six months of 2005, we have experienced operating and net losses. Also, our inability to collect outstanding receivables continues to impact our liquidity. On November 25, 2003, we completed the Financing totaling $6,850,000 with Laurus Master Fund, Ltd. (“Laurus”), and we also completed the Additional Financing totaling $3,350,000 on November 26, 2004 with Laurus in order to meet our current liquidity needs. We have substantial debt obligations of approximately $10,053,917 as of December 31, 2004.

As of July 31, 2005, we have $1,250,000 available for borrowing under the Additional Financing. There can be no assurance that our current financing facilities will be sufficient to meet our current working capital needs or that we will have sufficient working capital in the future.

The aforementioned problems, coupled with increasing debt, have continued to negatively impact our financial condition. If the operating conditions do not improve, there can be no assurance we will continue operations. There can be no assurance that the sale of the ATM business will be consummated. If we need to seek additional financing, there can be no assurances that we will obtain such additional financing for working capital purposes. The failure to obtain such additional financing could cause a material adverse effect upon our financial condition.

Management's Current Plans with Regard to Our Liquidity Include the Following:

Proposed Sale of ATM Business

On February 19, 2005, We and our wholly-owned subsidiary Tidel Engineering, L.P. (together with the Company, the "Sellers") entered into an asset purchase agreement with NCR Texas LLC, a single member Delaware limited liability company ("NCR") that is a wholly-owned subsidiary of NCR Corporation, a Maryland corporation, for the sale of the registrant's ATM business (the "Asset Purchase Agreement").

Engagement of Investment Banker to Evaluate Strategic Alternatives for the Sale of the Cash Security Business

We engaged Stifel, Nicolaus & Company, Inc. ("Stifel") in October 2004, to assist the Board of Directors in connection with the proposed sale of our Cash Security business, deliver a fairness opinion, and render such additional assistance as we may reasonably request in connection with the proposed sale of our Cash Security business. We are currently working with Stifel in connection with such a proposed sale.

Off-Balance Sheet Arrangements

We do not have any significant off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Contractual Obligations and Capital Expenditures

We have fixed debt service and lease payment obligations under notes payable and operating leases for which we have material contractual cash obligations. Interest rates on our debt vary from prime rate plus 2% to 14%.

The following table summarizes our contractual cash obligations as of December 31, 2004:

	PAYMENTS DUE BY FISCAL YEAR					
	2005	**2006**	**2007**	**2008**	**2009**	**Thereafter**
Operating leases	$ 484,135	$ 168,520	$ —	$ —	$ —	$ —
Long-term debt, including current portion (1)	1,885,929	3,000,000	3,667,988	1,500,000	—	—
Total	$ 2,370,064	$ 3,168,520	$ 3,667,988	$ 1,500,000	$ —	$ —

(1) Our total debt was $10,053,917 as of December 31, 2004.

Planned capital expenditures for 2005 and 2006 are estimated to be approximately $200,000 per year. These expenditures will depend upon available funds, levels of orders received and future operating activity.

Risk Factors

Please see the risk factors contained in the '03/'04 Annual Report.

Forward-Looking Statements

In addition to historical information, Management's Discussion and Analysis of Financial Condition and Results of Operations includes certain forward-looking statements regarding events and financial trends that may affect our future operating results and financial position. Some important factors that could cause actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements include the following:

- our substantial current indebtedness continues to adversely affect our financial condition and the availability of cash to fund our working capital needs;
- our ability to comply with our financial covenants in the future;
- our ability to meet our obligations under the terms of our indebtedness;
- our need for additional financing in the future;
- the potential receipt of an audit opinion with a "going concern" explanatory paragraph from our independent registered public accounting firm;
- our history of operating losses and our inability to make assurances that we will generate operating income in the future;
- the outcome of the outstanding receivable from CCC;
- the levels of orders which are received and can be shipped in a quarter;
- customer order patterns and seasonality;
- costs of labor, raw materials, supplies and equipment; technological changes;
- the delisting of our common stock from the NASDAQ Small Cap Market, effective as of the close of business on March 26, 2003, and the possibility of devaluation of our common stock as a result;
- the economic condition of the ATM industry and the possibility that it is a mature industry;
- the risks involved in the expansion of our operations into international offshore oil and gas producing areas, where we have previously not been operating;
- the continued active participation of our executive officers and key operating personnel; and
- our compliance with the Sarbanes-Oxley Act of 2002 and the significant expansion of securities law regulation of corporate governance, accounting practices, reporting and disclosure that affects publicly traded companies, particularly related to Section 404 dealing with our system of internal controls.

Many of these factors are beyond our ability to control or predict. We caution investors not to place undue reliance on forward-looking statements. We disclaim any intent or obligation to update the forward-looking statements contained in this report, whether as a result of receiving new information, the occurrence of future events or otherwise.

These and other uncertainties related to the business are described in detail under the headings of “Risk Factors” and “Forward-Looking Statements” in Item 7A of our ‘03/’04 Annual Report.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At December 31, 2004, we were exposed to changes in interest rates as a result of significant financing through our issuance of variable-rate and fixed-rate debt. However, with the retirement of our 6% subordinated convertible debentures subsequent to September 30, 2002, and the associated overall reduction in outstanding debt balances, our exposure to interest rate risks has significantly decreased. If market interest rates had increased 1% in the first three months of fiscal 2005, there would have been no material impact on our consolidated results of operations or financial position.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Mark K. Levenick, our Interim Chief Executive Officer, and Robert D. Peltier, our Interim Chief Financial Officer, have evaluated the effectiveness of the design and operation of our “disclosure controls and procedures”, as such term is defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). James T. Rash was Chief Executive and Chief Financial Officer during the fiscal years ended 2002, 2003 and 2004. Mr. Rash died on December 19, 2004. Mr. Levenick was appointed Interim Chief Executive Officer on December 22, 2004. During fiscal years 2002, 2003 and 2004, Mr. Levenick served as Chief Operating Officer and Director of the Company, and President and Chief Executive Officer of Tidel Engineering, L.P., the Company’s principal operating subsidiary. In February 2005, Mr. Robert D. Peltier joined the Company as Interim Chief Financial Officer, having had no prior affiliation with the Company. Mr. Peltier began his assessment of disclosure controls and internal controls without having ever been in a position of active management or knowledge over transactions during fiscal years 2002, 2003 or 2004.

In conducting our evaluation of disclosure controls and procedures, our Chief Executive Officer and our Chief Financial Officer made inquiries with accounting, administrative and operational personnel and reviewed the historical facts, including the Company’s failure to file its periodic reports on a timely basis. Our Chief Executive Officer and our Chief Financial Officer noted that the Company had failed to file any periodic report required to be filed under the Exchange Act from September 30, 2002 to February 1, 2005, on which date we filed our Form 10-K for the fiscal year ended September 30, 2002, which was more than two years late. Furthermore, it was noted that this Form 10-K for the fiscal years ended September 2003 and 2004, and the Company’s Forms 10-Q for the quarterly periods ended December 31, 2004 and March 31, 2005 were filed on August 1, 2005, were each at least several months delinquent. In their evaluation, our Chief Executive Officer and our Chief Financial Officer noted that the Company’s periodic reporting failure was caused by (1) limited financial and personnel resources at the times such forms were due that restricted our ability to compile our financial statements and cause such statements to be reviewed and/or audited by an independent registered public accounting firm when such forms were due and (2) the prolonged illness and death of our former Chairman, Chief Executive Officer and Chief Financial Officer during the year ended December 31, 2004. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company had a significant deficiency in its disclosure controls and procedures related to timely periodic reporting and such controls and procedures were not effective as of the end of the quarter ended December 31, 2004.

In February 2005, in order to remedy this deficiency the Company began implementing new disclosure controls and procedures, which consisted of: (1) the hiring of a new Chief Financial Officer to oversee the Company’s financial reporting process, (2) the establishment of a reporting timetable to file all delinquent reports by August 1, 2005 and return to timely periodic reporting by August 19, 2005, which was submitted and approved by our Board of Directors and (3) the establishment of new guidelines for completion of periodic accounting and reporting tasks. Such implementation was completed by August 19, 2005, at which time we resumed the timely filing of our periodic reports. As of August 19, 2005, our Chief Executive Officer and our Chief Financial Officer believe that this significant deficiency has been remedied.

In addition, in a report to the Audit Committee of the Board of Directors of the Company dated July 28, 2005, the Company's independent registered public accountants noted that the following significant deficiencies in our internal controls and procedures were discovered during the course of their audit of the financial statements for fiscal years ended September 30, 2003 and 2004: (1) established credit policies were overridden on occasion by executive management based on their business judgment at that time, (2) bookkeeping at the corporate level was not administrated on a timely basis during 2003 and 2004 and (3) the Company's accounts payable supervisor had access to the check signature and the ability to prepare check runs without proper review prior to distribution. In examining the significant deficiencies, both the Company and our independent registered public accountants performed expanded reviews of our procedures and mitigating controls to determine whether such deficiencies constituted a material weakness. In the expanded reviews, both the Company and our independent registered public accountants noted the following controls were in place prior to the audit of our financial statements for the fiscal years ended September 30, 2003 and 2004: (1) Management of the Company consistently performed weekly and monthly reviews of actual and budgeted results during the periods, (2) the Audit Committee of the Board of Directors of the Company provided additional oversight with respect to financial reporting beginning immediately after the death of our Chief Executive and Chief Financial Officer in December 2004, and (3) the Company hired a new Chief Financial Officer in February 2005 to oversee the Company's financial reporting process. We collectively concluded that since such additional controls were in place the Company was able to conclude that none of the deficiencies constituted a material weakness that resulted in more than a remote likelihood that a material misstatement of the annual or interim financial statements would not be prevented or detected. Further, the report of the independent registered public accountants indicated no inappropriate or unauthorized activity during the periods reviewed.

In August 2005, the Company began implementing revised internal controls and procedures to correct the significant deficiencies in our internal controls and procedures noted by our independent registered public accountants, which consisted of: (1) the establishment of new credit approval policies, including Board-level approval for certain amounts, (2) the establishment new guidelines for timely administration of bookkeeping tasks at the corporate level, including the implementation of monthly, quarterly and annual closing schedules and (3) removal of check signature access from the Company's accounts payable supervisor. Such implementation was completed by August 30, 2005, and as of that date our Chief Executive Officer and our Chief Financial Officer believe that these significant internal controls and procedures deficiencies no longer exist.

A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affect the entity's ability to authorize, initiate, record, process or report external financial data reliably in accordance with generally accepted accounting principles in the United States such that there is more than a remote likelihood that a misstatement of the entity's annual or interim financial statements that is more than inconsequential will not be prevented or detected.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations on all control systems, no evaluation of controls can provide absolute assurance that all errors, control issues and instances of fraud, if any, with a company have been detected. The design of any system of controls is also based in part on certain assumptions regarding the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Our Chief Executive Officer and our Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective at this reasonable assurance level as of August 19, 2005.

(b) Changes in internal control over financial reporting

Following the evaluations discussed above and the identification of significant deficiencies, the Company took the actions and implemented the procedures described above. There were no changes in our internal control over financial reporting that occurred in the quarter ending December 31, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As discussed in our ‘03/’04 Annual Report, on June 9, 2005, Corporate Safe Specialists, Inc. (“CSS”) filed a lawsuit against Tidel Technologies, Inc. and Tidel Engineering, L.P. The lawsuit, Civil Action No. 02-C-3421, was filed in the United States District Court of the Northern District of Illinois, Eastern Division. CSS alleges that the Sentinel product sold by Tidel Engineering, L.P. infringes one or more patent claims found in CSS patent U.S. Patent No. 6,885,281 (the ‘281 patent). CSS seeks injunctive relief against future infringement, unspecified damages for past infringement and attorney’s fees and costs. Tidel Technologies, Inc. was released from this lawsuit, but Tidel Engineering, L.P. remains a defendant. We continue to vigorously defend this litigation.

Also, as discussed in our ‘03/’04 Annual Report, we have filed a motion to dismiss the case CSS filed in Illinois, and Tidel Engineering, L.P. has filed a motion to transfer the Illinois case to the Eastern District of Texas. We have also filed a declaratory judgment action pending in the Eastern District of Texas. In that action, we are asking the Eastern District of Texas to find, among other things, that we have not infringed on CSS’s ‘281 patent. Both companies have also requested that an injunction be issued by the Eastern District of Texas against CSS for intentional interference with the sale or bid process for our cash security business. We are vigorously pursuing this declaratory judgment action.

We and several of our officers and directors were named as defendants (the “Defendants”) in a purported class action filed on October 31, 2001 in the United States District Court for the Southern District of Texas (the “Southern District”), George Lehockey v. Tidel Technologies, et al., H-01-3741. Prior to the suit’s filing, four identical suits were also filed in the Southern District. On or about March 18, 2002, the Court consolidated all of the pending class actions and appointed a lead plaintiff under the Private Securities Litigation Reform Act of 1995 (“Reform Act”). On April 10, 2002, the lead plaintiff filed a Consolidated Amended Complaint (“CAC”) that alleged that the Defendants made material misrepresentations and omissions concerning our financial condition and prospects between January 14, 2000 and February 8, 2001 (the putative class period). In June 2004, we reached an agreement in principle to settle these class action lawsuits. The settlement, which was subject to a definitive agreement and court approval, provided for a cash payment of $3 million to be funded by our liability insurance carrier and our issuance of two million shares of common stock. In addition, in August 2004, we reached an agreement with the liability insurance carrier to issue warrants to the carrier to purchase 500,000 shares of our common stock at an exercise price of $0.67 per share in exchange for the carrier’s acceptance of the terms of the class action lawsuit. We provided a reserve of $1,564,490 in fiscal 2002 to cover any losses from this litigation, which consisted of $1,340,000 related to the shares of common stock issued and $224,490 related to the value of the warrants issued. The common stock was valued using the stock price on the date issued and the warrants were valued using the Black-Scholes pricing method. In October 2004, the Court approved the settlement and the shares were issued in November 2004.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

We and several of our officers and directors were named as defendants (the “Defendants”) in a purported class action filed on October 31, 2001 in the United States District Court for the Southern District of Texas (the “Southern District”). The settlement, which was subject to a definitive agreement and court approval, provided for a cash payment of $3 million to be funded by our liability insurance carrier and our issuance of two million shares of common stock. In October 2004, the Court approved the settlement and 2,000,000 shares were issued in November 2004.

Pursuant to the $3,350,000 Additional Financing with Laurus on November 26, 2004, we issued 1,251,000 shares of our common stock during November 2004.

ITEM 6. EXHIBITS

*31.1 Certification of Interim Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

*31.2 Certification of Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

*32.1 Certification of Interim Chief Executive Officer pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*32.2 Certification of Interim Chief Financial Officer pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* - Filed herewith.

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.

	TIDEL TECHNOLOGIES, INC. (Company)
November 30, 2005	/s/ MARK K. LEVENICK Mark K. Levenick Interim Chief Executive Officer
November 30, 2005	/s/ ROBERT D. PELTIER Robert D. Peltier Interim Chief Financial Officer

James T. Rash, our former Chairman, Chief Executive Officer and Chief Financial Officer, died on December 19, 2004. We appointed Mark K. Levenick to the position of Interim Chief Executive Officer but no permanent Chairman, Chief Executive Officer or Chief Financial Officer has been hired or appointed as of the date hereof. Robert D. Peltier was appointed Interim Chief Financial Officer in February 2005.

INDEX TO EXHIBITS

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