UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____TO_____

Commission File Number: 0-12254

SCIENTIFIC TECHNOLOGIES INCORPORATED

(Registrant)

Oregon	77-0170363
(State of incorporation)	(I.R.S. Employer Identification Number)
6550 Dumbarton Circle, Fremont, California	94555
(Address of principal executive offices)	(Zip Code)

(510) 608-3400
(Registrant's telephone number)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12-b2 of the Exchange Act). Yes___ No__X__

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b2 of the Exchange Act). Yes___ No__X__

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock outstanding as of October 15, 2005 was 9,773,522 shares.

SCIENTIFIC TECHNOLOGIES INCORPORATED
Quarter and Nine Months Ended September 30, 2005

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ITEM 1 - FINANCIAL STATEMENTS

SCIENTIFIC TECHNOLOGIES INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands, except for per share data)

Assets	Sep. 30, 2005	Dec. 31, 2004
Current assets:		
Cash and cash equivalents	$ 2,928	$ 1,107
Short-term investments	2,441	2,350
Accounts receivable, net	8,235	7,746
Inventories	9,717	10,584
Deferred income taxes	3,826	3,826
Receivable from Parent	384	941
Prepaid expenses and other assets	591	394
Total current assets	28,122	26,948
Property and equipment, net	3,105	3,470
Goodwill	216	216
Other intangible assets, net	1,848	2,097
Other non-current assets	749	605
Total assets	$34,040	$33,336
Liabilities and Shareholders' Equity		
Current liabilities:		
Bank overdraft	$ --	$ 517
Accounts payable	3,002	3,246
Accrued expenses	1,033	1,711
Accrued compensation	2,202	2,209
Current portion of capital lease with Parent	68	68
Total current liabilities	6,305	7,751
Capital lease with Parent	45	96
Deferred income taxes	118	118
Total liabilities	6,468	7,965
Commitments and contingencies (Note 6)		
Shareholders' equity:		
Common stock, $.001 par value; 100,000 shares authorized; 9,773 and 9,764 shares issued and outstanding	10	10
Capital in excess of par value	6,003	5,992
Retained earnings	21,559	19,369
Total shareholders' equity	27,572	25,371
Total liabilities and shareholders' equity	$34,040	$33,336

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

SCIENTIFIC TECHNOLOGIES INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, in thousands, except per share data)

	For the three months ended		For the nine months ended	
	Sep. 30, 2005	Sep. 30, 2004	Sep. 30, 2005	Sep. 30, 2004
Sales	$15,002	$14,604	$44,241	$44,876
Write down of intangible assets	--	727	--	727
Cost of sales	8,585	9,176	26,176	26,946
Gross profit	6,417	4,701	18,065	17,203
Operating expenses:				
Selling, general and administrative	4,387	4,296	13,175	13,081
Research and development	917	960	3,081	2,990
Write down of intangible assets	--	1,275	--	1,275
Amortization of intangible assets	47	170	112	511
Total operating expenses	5,351	6,701	16,368	17,857
Income (loss) from operations	1,066	(2,000)	1,697	(654)
Interest and other income, net	87	76	237	193
Income (loss) before income taxes	1,153	(1,924)	1,934	(461)
Provision (benefit) for income taxes	(507)	(731)	(256)	(175)
Net income (loss)	$ 1,660	$(1,193)	$ 2,190	$ (286)
Net income (loss) per share:				
Basic and diluted	$ 0.17	$ (0.12)	$ 0.22	$ (0.03)
Shares used to compute net income per share:				
Basic	9,773	9,735	9,771	9,734
Diluted	9,774	9,735	9,772	9,734

The accompanying notes are an integral part of these financial statements

SCIENTIFIC TECHNOLOGIES INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	For the nine months ended	
	Sep. 30, 2005	Sep. 30, 2004
Cash flows from operating activities		
Net income (loss)	$ 2,190	$ (286)
Adjustments to reconcile net income to cash provided by operating activities:		
Allowance for doubtful accounts	(81)	(164)
Impairment of goodwill and intangible assets	--	2,002
Depreciation and amortization	1,234	1,962
Gain on equity investment in affiliate	--	(162)
Loss on disposal of property and equipment	2	--
Warranty reserve	269	96
Changes in assets and liabilities		
Accounts receivable	(408)	(237)
Inventories	867	(1,476)
Receivable from Parent	557	101
Deferred income taxes	--	(760)
Prepaid expense and other assets	(341)	361
Accounts payable	(244)	(260)
Accrued expenses	(954)	453
Cash flows provided by operating activities	3,091	1,630
Cash flows from investing activities		
Purchase of short-term investments	(91)	--
Proceeds from sale of fixed assets	10	--
Purchase of property and equipment	(632)	(913)
Cash flows used in investing activities	(713)	(913)
Cash flows from financing activities		
Repayment of capital lease with Parent	(51)	(51)
Increase (decrease) in bank overdraft	(517)	117
Issuance of common stock	11	120
Cash flows provided by (used in) financing activities	(557)	186
Change in cash and cash equivalents	1,821	903
Cash and cash equivalents at beginning of period	1,107	2,645
Cash and cash equivalents at end of period	$ 2,928	$ 3,548
Supplemental disclosure of cash flow information:		
Cash paid to Parent for income taxes	$ --	$ 585
Supplemental disclosure of non-cash activities:		
Cash paid to Parent for capital lease	$ 51	$ 51

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

SCIENTIFIC TECHNOLOGIES INCORPORATED

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. INTERIM FINANCIAL STATEMENTS

The accompanying condensed consolidated financial statements for the three and nine months ended September 30, 2005 and 2004 are unaudited and have been prepared in accordance with generally accepted accounting principles in the United States of America and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles in the United States of America for complete financial statements. In the opinion of management, the unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, considered necessary to present fairly the financial position, results of operations and cash flows of Scientific Technologies Inc. (the “Company”) and its subsidiaries for all periods presented.

To prepare these condensed consolidated financial statements in conformity with generally accepted accounting principles, management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities at the date of the financial statements and revenue and expenses during the reporting period. Actual results could differ from those estimates.

The results of operations are not necessarily indicative of the results to be expected in the future or for the full fiscal year. It is recommended that these condensed consolidated financial statements be read in conjunction with the Company’s audited consolidated financial statements and the notes thereto included in its 2004 Annual Report on Form 10-K.

The Company is an Oregon corporation and is substantially owned by Scientific Technology Incorporated, a California corporation (the “Parent”). See discussion of intercompany activities below.

BASIS OF PRESENTATION

The consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of all significant intercompany accounts and transactions.

RECLASSIFICATIONS

Certain items previously reported in specific financial statement captions have been reclassified to conform to 2005 presentation as follows:

1. Certain sales reserves have been reclassified from accrued expenses to contra accounts receivable.
2. Adjustable rate short-term investments (“auction rate securities”) have been reclassified from cash and cash equivalents.
3. Bank overdrafts have been reclassified from cash and cash equivalents.

STOCK-BASED COMPENSATION

The following table sets forth the effect on the Company's net income and net income per share as if the Company had recorded compensation costs based on the estimated grant date fair value as defined by Statement of Financial Accounting Standards (SFAS) No. 123 for all granted stock-based awards (in thousands, except per share amounts).

	Nine Months Ended September 30	
	2005	2004
Net income (loss), as reported	$2,190	$ (286)
Deduct: Stock-based employee compensation expense determined under fair value based method for all awards, net of tax	76	52
Pro forma net income (loss)	$2,114	$(338)
Net income (loss) per share - basic and diluted:		
As reported	$ 0.22	$ (0.03)
Pro forma	$ 0.22	$ (0.03)

Options to purchase 10,000 and 17,000 shares of common stock were granted in the nine months ended September 30, 2005 and 2004, respectively. All options were granted at fair market value.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in the nine months ended 2005 and 2004: Dividend yield of 0%; expected volatility of 45%, risk-free interest rate of 1%, and expected life of 5 years.

2. INVENTORIES

Inventories consist of the following (in thousands):

	Sep. 30, 2005	Dec. 31, 2004
Raw materials	$ 4,569	$ 5,705
Subassemblies	1,613	1,518
Work in process	441	616
Finished goods	3,094	2,745
	$ 9,717	$10,584

3. NET INCOME PER SHARE

A reconciliation of the numerators and denominators used to compute basic and diluted income per common share is provided below.

	(In thousands)		(Per share)
Three months ended September 30, 2005	Income	Shares	Amount
Basic earnings per share calculation	$ 1,660	9,773	$ 0.17
Effect of dilutive securities			
Stock options		1	
Diluted earnings per share calculation	$ 1,660	9,774	$ 0.17

Three months ended September 30, 2004	Income	Shares	Amount
Basic and dilutive loss per share calculation	$(1,193)	9,735	$(0.12)

Nine months ended September 30, 2005	Income	Shares	Amount
Basic earnings per share calculation	$ 2,190	9,771	$ 0.22
Effect of dilutive securities			
Stock options		1	
Diluted earnings per share calculation	$ 2,190	9,772	$ 0.22

Nine months ended September 30, 2004	Income	Shares	Amount
Basic and dilutive loss per share calculation	$ (286)	9,734	$(0.03)

4. RELATED PARTY TRANSACTIONS

The Company provides certain management services to the Parent such as general management and accounting services. The Company charges the cost of these services to the Parent based upon the amount of time employees spent providing these services. Management services charged by the Company to the Parent for the nine months ending September 30, 2005 and 2004 totaled $224,000 and $245,000 respectively.

The Company leases essentially all of a 99,500 square foot facility owned by an affiliate of the Parent. The Company also leases another 25,000 square feet in another facility owned by the same affiliate. Overhead costs are allocated primarily on the basis of square footage utilized by each party. Amounts paid to this affiliate were $257,000 per quarter during the quarters ended September 30, 2005 and 2004. In addition, the Company is party to a capital equipment lease of $113,000 at September 30, 2005 under which the Parent is the lessor.

The Company utilizes a receivable from/payable to Parent account to record activity including cash received, cash disbursed and amounts owed to and receivable from the Parent for allocated charges. The net effect of transactions with the Parent resulted in a receivable from Parent of $384,000 at September 30, 2005.

The Company is included in the consolidated tax return of the Parent, but provides for income taxes on a separate return basis. During the third quarter, the Company reached an agreement with the Internal Revenue Service which allowed the Company to file amended federal and state income tax returns for the years ended December 31, 1999, 2000, 2001, 2002 and 2003 these amendments allowed the Company to realize additional income tax credits and record a tax benefit for the three and nine months ended September 30, 2005. Income taxes payable are recorded as a reduction to the receivable from Parent account or as an increase to the payable to Parent account.

The Company owns 50% of Aurora Technology Pte. Ltd ("Aurora"), in a joint venture with Amplus Communication Pte. Ltd. Aurora. Aurora, a Singapore manufacturing company, manufactures and sells sub-assemblies and other components to the Company and others. Amounts purchased from Aurora for the nine months ended September 30, 2005 were $5,124,000. The carrying value of our investment in Aurora, which is accounted for under the equity method, amounted to approximately $678,000 at September 30, 2005 and $550,000 at December 31, 2004.

5. SEGMENT REPORTING AND OTHER INFORMATION

The Company is organized into two business segments: Safety Products Group, whose products include safety light curtains, safety interlocks and relays, safety mats and controllers, safety contact strips, and optical profiling scanners, and installation services, and Automation Products Group, whose products include photoelectric and fiberoptic sensors, control components, power monitoring electronics, defense electronics, industrial control microcomputers, peripherals and software, level and flow sensors, non-contact ultrasonic sensors and controllers, pressure transducers, digital pressure gauges, displacement and velocity transducers and pressure comparators.

Financial information for each product group is as follows: (in thousands)

	Three months ended September 30,		Nine months ended September 30,	
Safety Products	2005	2004	2005	2004
Sales	$12,523	$12,522	$37,705	$37,859
Group operating profit (loss)	880	(1,962)	2,171	(894)
Automation Products				
Sales	$ 2,479	$ 2,082	$ 6,536	$ 7,017
Group operating profit (loss)	186	(38)	(474)	240

	At	
	Sep. 30	Dec. 31
Total Assets	2005	2004
Safety Products	$24,761	$25,868
Automation Products	9,279	7,468
Total	$34,040	$33,336

The Company operates principally in the United States. Sales to foreign customers represented 18% and 16%, respectively, of total sales in the three and nine months ended September 30, 2005, compared to 13% in the comparable periods in 2004.

6. COMMITMENTS AND CONTINGENCIES

The Company offers warranties on certain products and records a liability for the estimated future costs associated with warranty claims, which is based upon historical experience and the Company's estimate of the level of future costs. A reconciliation of the changes in the Company's warranty liability follows (in thousands):

	Three months ended September 30	
	2005	2004
Warranty accrual at beginning of period	$272	$221
Accruals for warranties issued	151	54
Expenses incurred	(125)	(57)
Warranty accrual at end of period	$298	$218

	Nine months ended September 30	
	2005	2004
Warranty accrual at beginning of period	$285	$221
Accruals for warranties issued	269	96
Expenses incurred	(256)	(99)
Warranty accrual at end of period	$298	$218

As permitted under Oregon law the Company has agreements whereby the Company indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was serving at the Company's request in such capacity. The indemnification term is for the period that the officer or director is serving in such capacity or is subject to any possible claim or action by reason of the fact that the Indemnitee was serving in that capacity. The maximum potential amount of future payments by the Company could be unlimited; however the Company has a director and officer insurance policy that limits the Company's exposure and enables the Company to recover a portion of any future amounts paid. As a result of the insurance policy coverage, the Company believes that the estimated fair value of these agreements is minimal.

7. RECENT ACCOUNTING PRONOUNCEMENTS
The Financial Accounting Standards Board (FASB) has issued SFAS No. 123 (revised 2004), “Share-Based Payment”. Under the provisions of SFAS 123R, companies are required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exception). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award, usually the vesting period. SFAS 123R is effective for annual periods that begin after June 15, 2005. SFAS 123R applies to all awards granted, modified, repurchased or cancelled by us after December 31, 2005 and to unvested options at the date of adoption. The Company does not expect the adoption of SFAS 123R to have a material impact on our results of operations, financial position or liquidity.

The FASB issued SFAS No. 154, “Accounting Changes and Error Corrections”, which replaces APB Opinion No. 20, “Accounting Changes” and SFAS No. 3, “Reporting Accounting Changes in Interim Financial Statements”. This pronouncement applies to all voluntary changes in accounting principle, and revises the requirements for accounting for and reporting a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle, unless it is impracticable to do so. This pronouncement also requires that a change in the method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is effected by a change in accounting principle. SFAS No. 154 retains many provisions of APB Opinion 20 without change, including those related to reporting a change in accounting estimate, a change in the reporting entity, and correction of an error. The pronouncement also carries forward the provisions of SFAS No. 3 which govern reporting accounting changes in interim financial statements. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Statement does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of SFAS No. 154. We do not expect the adoption of SFAS 151 to have a material impact on our results of operations, financial position or liquidity.

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

This interim report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Act of 1934. Such forward-looking statements include, but are not limited to, statements regarding the sufficiency of existing cash and future cash flows to satisfy future operating and capital requirements. The Company's actual results could differ materially from those projected in such forward-looking statements as a result of many factors, including, without limitation, those set forth under this section, the section entitled "Business Factors" below and elsewhere in this report on Form 10-Q.

Results of Operations

(Amounts in thousands, except percentages)

Scientific Technologies Incorporated (the "Company") is headquartered in Fremont, California and designs, manufactures and distributes electrical and electronic industrial controls such as machine safety and automation sensing products. Our product lines include safety light curtains, safety interlock switches, safety relays, profiling scanners, factory automation sensors, controls, fiber optics, power monitoring, safety mats, safety contact strips, non-contact ultrasonic sensors and controllers, pressure transducers and other electronic equipment supplied to industrial automation, commercial and defense customers. We are organized into two product groups, The Safety Products Group (SPG), comprised of the Optical Sensor Division (OSD) and the Machine Services Division (MSD) and the Automation Products Group (APG).

Sales for the three and nine months ended September 30, 2005 increased 1% and declined 3% respectively, to $15,002 and $44,241 from $14,604 and $44,876 in the comparable 2004 periods. For the three months ended September 30, 2005, SPG sales were essentially flat compared to the same 2004 period. MSD sales increased by $556, while OSD sales declined by the same amount. OSD was negatively impacted by lower sales of light curtains and vehicle scanners. For the three months ended September 30, 2005, APG recorded higher sales of level sensor and control components products compared to the same period in 2004. For the first nine months of 2005, SPG sales were slightly below the same period in 2004. Increased sales of light curtains, interlocks and relays by OSD were offset by lower vehicle scanner sales. Lower project and service revenue at MSD was partially offset by sales of LazerSafe products. For the first nine months of 2005, APG sales were 7% below 2004, primarily due to lower sales of pressure products offsetting increased ultrasonic and level sensing products.

For the third quarter of 2005, gross profit as a percent of sales (gross margin) improved to 43% from the 32% recorded in the same period in 2004. During the third quarter of 2004, we experienced an impairment of certain intangible assets originating from our purchase of MSD. Excluding this write down, gross margin in the third quarter of 2004 was 37%. The improvement in this measure of gross margin in the third quarter of 2005 when compared to the comparable quarter in 2004 was the result of increased volume at APG, coupled with the cost savings which resulted from the relocation of the pressure products from Tulare, California to our facility in Logan, Utah. The Tulare facility was closed in March, 2005. In addition SPG benefited from higher margins related to increased sales of LazerSafe products at MSD. Gross margin for the nine months ended September 30, 2005 improved to 41% from 38% in the comparable period in 2004. In addition to the nonrecurring intangible write down of 2004, gross margin was positively impacted by improved profitability at MSD and the nine month effect of the APG cost reductions.

Selling, general and administrative expenses for the three and nine months ended September 30, 2005 increased to $4,387 and $13,175, respectively, from $4,296 and $13,081 over the same 2004 periods. During 2005, we opened a sales and service office in China to expand our global presence and take advantage of opportunities available in this large market place. As a percentage of sales for the three and nine months ended September 30, 2005, selling, general and administrative expenses were 29% and 30%, respectively, compared to 29% for the same periods in 2004.

Research and development expenses declined 4% to $917 compared to $960 recorded in the third quarter of 2004, as a result of lower material and outside product certification expenses. For the nine months ended September 30, 2005 research and development expenses rose 3% to $3,081 from $2,990 in the same period in 2004. This was the result of higher staffing levels and material usage at APG offsetting lower material and outside service expenses at OSD. As a percentage of sales, research and development expenses were 6% and 7% in the third quarter and first nine months of 2005 compared to 7% in the same periods in 2004.

As a result of the intangible impairment write downs in the second half of 2004, third quarter and nine months 2005 amortization expense were reduced by 72% and 78% respectively.

During the third quarter, we reached an agreement with the Internal Revenue Service which allowed us to file amended federal and state income tax returns for the years ended December 31, 1999, 2000, 2001, 2002 and 2003 which allowed us to realize additional income tax credits and record a tax benefit for the three and nine months ended September 30, 2005. The effective tax rate as of September 30, 2005 was (13%).

Contractual Obligations

The Company has no raw material contracts exceeding one year in duration. In addition, the Company leases production, warehouse and corporate office space as well as certain equipment under non-cancelable operating lease agreements. All building leases have renewal options and all include cost of living adjustments. The following table summarizes the estimated annual obligations.

Payments due by period (in thousands)

Contractual Obligations	Total	Less than 1 year	1 - 3 years	3 - 5 years	Over 5 years
Capital Lease Obligations	$ 113	$ 68	$ 45	$ -	$ -
Operating Leases	$1,185	$276	$ 126	$126	$657
Total	$1,298	$344	$171	$126	$657

Liquidity and Capital Resources
(Amounts in thousands)

We had cash and cash equivalents at September 30, 2005 and December 31, 2004 of approximately $2,928 and $1,107 respectively. Our short-term investments were $2,441 and $2,350 at September 30, 2005 and December 31, 2004, respectively

For the nine months ended September 30, 2005 cash provided by operations was $3,091 compared to $1,630 in the same period in 2004. Net income was $2,476 higher in the nine months ended September 30, 2005, compared to the same period in 2004. In addition, we experienced an inventory reduction of $867 during the first nine months of 2005 compared to an increase of $1,503 in the first nine months of 2004. The inventory reduction in 2005 was due to the increased sales and new products introduced in 2005. The inventory increase in 2004 related to anticipation of increased sales and new products to be introduced in 2005. Receivable from Parent was reduced by $557 in the nine months ended September 30, 2005, compared to a $101 reduction in the same 2004 period. Accounts payable was reduced by $244, and accrued expenses were reduced by $698 in the nine months ended September 30, 2005, respectively, compared to a reduction of $260 and an increases of $656 in the comparable period in 2004. Other assets grew by $341 in the first three quarters of 2005 compared to a reduction of $361 in the comparable 2004 period.

Available bank borrowings were $6,000, all of which were unused at September 30, 2005. The Company's revolving line of credit was renewed in 2005 through September 30, 2006. We are in compliance with all loan covenants under this facility.

We believe that our existing cash and cash equivalent balances, short-term investments and anticipated cash flows from operations will be sufficient to meet our operating and capital requirements for at least the next 12 months. However, revenues could decline below our expectations resulting in insufficient cash flow from operations or we may require additional financing to fund new product development, strategic investments in new markets, and strategic acquisitions. As a result, we could be required, or could elect, to raise additional funds during that period and we may need to raise additional capital in the future. Additional capital may not be available at all, or may only be available on terms unfavorable to us. With the exception of operating leases, we have not entered into any off-balance sheet financing arrangements, we have not established any variable interest entities, we do not have any unconditional purchase obligations, nor do we have non-cancelable commitments for capital expenditures.

Critical Accounting Policies

There were no material changes in any of our critical accounting estimates or judgments during the first three quarters of 2005.

Revenue Recognition

The Company has product and services sales. Revenue from product sales to OEM's and distributors is recognized upon shipment when shipped FOB our plant or upon receipt by the customer when shipped FOB destination, if a signed purchase order exists, the price is fixed or determinable, collection of the resulting receivable is considered reasonably assured and product returns can be reasonably estimated. Subsequent to the sale of the products, we have no obligation to provide any modification or customization, upgrades, enhancements or post contract customer support.

Our agreements with our distributors include certain product rotation, price protection, and warranty rights. All distributors have the right to rotate slow moving products four times each fiscal year. The maximum dollar value of inventory eligible for rotation is equal to eight percent of our products purchased by the distributor during the previous fiscal year. In order to take advantage of their product rotation rights, the distributors must order and take delivery of additional products equal to at least the dollar value of the products that they want to rotate. Reserves for the right of return and restocking are established based on the requirements of Statement of Financial Accounting Standards ("SFAS") 48, "*Revenue Recognition when Right of Return Exists*" because we have visibility into our distributor's inventory and have sufficient history to estimate returns. We record a reserve based on historical trend. Stock rotation and returns estimates are recorded as reductions of sales and cost of sales.

Each distributor is also allowed certain rebates and price protection rights. If and when we reduce or plan to reduce the price of any of our products and the distributor is holding any of the affected products in inventory, we will credit the distributor the difference in price when it places its next order with us. We record an allowance for price protection reducing our net sales and increasing our accrued liabilities based on specific terms and historical trend. Price protection estimates are recorded as reductions of sales and warranty estimates are recorded against cost of sales.

The Company provides a warranty to its customers for a period of 12 to 18 months. Upon revenue recognition, we provide for the estimated costs that may be incurred for product warranties. We estimate sales returns and warranty costs based on historical experience and the best information we have at the time we report our financial statements. Actual results could differ from these estimates. Warranty expenses are recorded against cost of sales.

Installation and engineering service revenue is recognized when services are rendered, or when an identifiable portion of the contract is completed, no significant post-delivery obligations exist and collection of the resulting receivable is considered reasonably assured.

Inventory Valuation

We value our inventory at the lower of the actual cost to purchase and/or manufacture the inventory or the current estimated market value of the inventory. We regularly review inventory quantities on hand and may write-down excess and obsolete inventory based primarily on our historical consumption and our estimated forecast of product demand and production requirements. Demand for our products can fluctuate significantly. In addition, our industry is characterized by technological change, new product development, and product obsolescence that could result in an increase in the amount of obsolete inventory quantities on hand. Our estimates of future product demand may differ from actual results, in which case we may adjust the provision required for excess and obsolete inventory. In the future, if our inventory is determined to be overvalued, we would be required to recognize such costs in our cost of goods sold at the time of such determination. Likewise, if our inventory is determined to be undervalued, we may have over-reported our costs of goods sold in previous periods and would be required to recognize such additional operating income at the time of sale. Therefore, although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of our inventory and our reported operating results.

Allowance for Doubtful Accounts

We maintain allowances for estimated losses from the inability of our customers to make required payments. We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current credit worthiness, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we had in the past. A significant change in the liquidity or financial position of any one of our customers could have an adverse impact on the collectability of our accounts receivable and our future operating results. An account is written off or written down to its net realizable value, when we determine that and it is in bankruptcy, liquidation or cannot be located or the cost of collection exceeds the realizable value of the account.

Valuation of Goodwill and Other Long-Lived Assets

We review the recoverability of our long-lived assets, such as fixed assets, goodwill, intangible assets and investments, when events or changes in circumstances indicate that the carrying amount of the asset or asset group may not be recoverable. We had no such impairment trigger event in the nine months ended September 30, 2005. The assessment of possible impairment is based on our ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between the estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-termed assets. In addition, we review the valuation of goodwill at least annually. Based on our review of the cash flows relative to the acquisition of MSD, Lundahl Instruments and PSI-Tronix, we believe the goodwill and other long-lived assets are not stated at more than their fair value.

Business Factors

Because of the variety of factors and uncertainties affecting our operating results, past financial performance and historical trends may not be a reliable indicator of future performance. These factors, as well as other factors affecting our operating performance, may result in significant volatility in our common stock price. Among the factors which could affect our future business, financial condition or operating results are the following:

Our operating results may fluctuate.

We have experienced fluctuations in annual and quarterly operating results and anticipate that these fluctuations will continue, which may cause the trading price of our common stock to decline. These fluctuations are caused by a number of factors described below and elsewhere in this section, including:

- the level and timing of customer orders;
- fluctuations in demand for complementary third party products with which our products are sold;
- changes in the mix of our products sold;
- timing of operating expenditures;
- timing of new product introductions;
- fluctuations in prices charged by our suppliers;
- seasonality of sales within our core markets;
- volatility in supply and demand affecting industrial control products generally, such as increases in the supply of competitive products and declines in selling prices; and
- economic conditions in the U.S. and abroad.

Our sales are dependent on independent distributors.

A majority of our sales are through third party distributors, system integrators and original equipment manufacturers. These resellers are not required to offer our products exclusively. We cannot assure that a reseller will continue to offer our products. In addition many of our resellers are privately owned firms which may not be well capitalized. If our ability to sell products through these third parties is impaired, our results of operations would likely suffer.

The industrial manufacturing equipment industry, and the markets of customers that use our products, are highly cyclical.

Our continued success depends in large part on the vibrancy of various industries that use our products. We operate in a cyclical industry that has been subject to significant economic downturns often in connection with, or in anticipation of, declines in general economic conditions. These types of downturns have occurred numerous times in the past, most recently in 2001. During such downturns, we experience reduced product demand, erosion of average selling prices and gross margins. Our business could be harmed in the future by additional cyclical downturns in the industrial manufacturing equipment industry or by slower growth by any of the markets served by our customers' products.

The markets in which we participate are intensely competitive.

Our core markets are intensely competitive. Many competitors have substantially greater name recognition and technical, marketing, distribution and financial resources than we have, and we may not be able to compete successfully with them in the future. Competitive pressures could also reduce market acceptance of our products and result in price reductions, decreases in revenues and increases in expenses. Competition in our core markets is based primarily on performance, quality, price and availability. If we do not compete successfully on these and other factors, our business, financial condition and operating results would be harmed.

<u>Average sales prices of our products generally decline over time.</u>
Average sales prices in the industrial manufacturing equipment market tend to decline over time as a result of competition, technological advances, manufacturing efficiencies and other factors. Declines in average sales prices for our products, if not offset by reductions in the cost of producing those products or by sales of new products with higher gross margins, would decrease our gross margins, could cause a negative adjustment to the value of our inventories and could materially and adversely affect our operating results.

<u>We do not have long term contracts with our customers.</u>
Our customers generally purchase our products on a purchase-order basis and do not have long-term contracts with us. As a result, we cannot be certain that our customers will continue to order products from us at the same or higher levels as in the past. The loss of one or more significant customers, or a decline in overall orders from our customers, would harm our business and operating results.

In addition, the lack of long-term sales contracts and significant order backlog makes it difficult for us to forecast future sales with certainty or to accurately forecast component and product requirements. These factors expose us to a number of risks:

- if we overestimate our requirements we may be obligated to purchase more components or third-party products than are required;
- if we underestimate our requirements, our suppliers may have an inadequate product or product component inventory, which could interrupt manufacturing of our products and result in delays in shipments and revenues;
- we may also experience shortages of product components from time to time, which also could delay the manufacturing of our products; and
- over or under production can lead to higher expenses, lower than anticipated revenues, and reduced margins.

<u>We may be unable to increase our international sales.</u>
We are attempting to develop, integrate and expand our international distribution networks in an effort to increase international sales of our products. We may not be successful in developing or expanding our international distribution network or in marketing and selling products in foreign markets. If the revenues generated by our international sales are not adequate to recover the expense of establishing, expanding, and maintaining an international distribution network, our business, financial condition, and results of operations could be materially adversely affected. If international sales become a more significant component of net sales, our business would be more vulnerable to risks inherent in doing business internationally, including:

- difficulties in managing foreign resellers;
- longer payment cycles and problems in collecting accounts receivable;

- the effects of seasonal customer demand;
- changes in regulatory requirements;
- difficulties in meeting the requirements of different international product regulations;
- risks relating to intellectual property rights;
- increased expenses due to efforts to localize our product offerings;
- export restrictions, tariffs and other trade barriers;
- fluctuations in currency exchange rates; and
- potentially adverse tax consequences and political instability.

The existence or occurrence of any one of these factors could have a material adverse effect on our business, financial condition, and results of operations.

<u>Our business could suffer if we are experience delays or are unable to transition certain of our products to conformance with new European hazardous substance regulations.</u>
The legislative and commercial actions in Europe regarding hazardous substances have brought a new level of environmental awareness to industrial equipment industries. Certain of our products that may fall within the scope of the Restriction on Hazardous Substances (RoHS) Directive may be required to conform to the new emerging restrictions and conventions. Delays or failure to transition current products to environmental compliance for the broad range of countries where our products are deployed may negatively impact revenues. Further, many of our commercial parts suppliers and contract manufacturers have begun or completed the conversion to meet this new emerging requirement. Should these efforts be delayed our supply chain of qualified components could prevent STI from meeting the deadline for compliance. Also our cost to become compliant could become more than currently projected, therefore negatively impacting our revenues and margin performance.

<u>We depend upon suppliers and outsourced manufacturers, several of which are located outside of the U.S. Disruption of our access to these supplies and services, or problems with the quality of supplies or services, could prevent us from filling customer orders and harm our business.</u>
The principal components of our products are purchased from outside vendors. We generally buy components under purchase orders, do not have long-term agreements with our suppliers, and we generally do not maintain large inventories of components. Any termination of, or significant disruption of, our relationships with the suppliers of our product components may prevent us from filling customer orders in a timely manner which could result in customer dissatisfaction and lost sales.
For some of our products, including private label products, we rely on third party manufacturers for subassembly of products and for final assembly, quality assurance, and testing of some of our products. These outsourcing arrangements and any future outsourcing arrangements involve numerous risks, including reduced control over product quality, delivery schedules, manufacturing yields, and costs.

<u>For certain products that we private label, we are dependent on third party suppliers.</u>
We rely on third party suppliers for several finished products that we sell under the STI brand name. If we do not manage the relationship with the supplier properly or if the supplier stops providing us with these products, we may not be able to find replacement products in a timely manner or at all. This may prevent us from fulfilling customer orders and have an adverse impact on our financial results.

Our business could suffer if we do not respond to technological change and new product development demands of our customers.

The market for our products is characterized by changing technology, evolving industry standards, changes in customer needs and new product introductions. Our future success will depend on our ability to respond to emerging industry standards, enhance current products, develop new products, and achieve market acceptance of those products, all on a timely and cost-effective basis. The introduction of new products also requires that we manage the transition from older products in order to minimize disruption of customer orders, avoid excessive levels of older product inventories and ensure that adequate supplies of new products can be delivered to meet customer demands.

Product errors or defects could result in product recalls and claims against us.

We manufacture machine safety and automation sensing products, many of which are used in manufacturing, construction and other industrial environments. Errors or defects in our products could contribute to injuries, and could subject us to product liability claims. Any such claims would divert management's attention from our core business, would be expensive to defend, and could result in sizeable damage awards against us. Our existing product liability insurance coverage may be inadequate to protect us from any liabilities we might incur, and we may not be able to maintain this insurance or do so at a reasonable cost or on reasonable terms. Any product liability claim brought against us, with or without merit, could also increase our product liability insurance rates or prevent us from securing any coverage in the future. If a product liability claim or series of claims is brought against us for uninsured liabilities or is in excess of our insurance coverage, our business would suffer. In addition, such claims may require us to recall some of our products, which could result in significant costs to us.

Fluctuations in currency exchange rates would have an adverse effect on our operating results and financial condition.

While substantially all of our sales are denominated in U.S. dollars, we purchase material for resale denominated in British pounds and Euros, and, in the future, we may transact business in other foreign currencies. Increases in value of the U.S. dollar relative to foreign currencies have the effect of increasing the prices of our products in foreign markets and, as a result, could harm sales of our products in those markets. Conversely, declines in value of the U.S. dollar relative to foreign currencies, as we have recently experienced, has the effect of increasing our operating expenses by increasing the cost of materials we purchase for resale in British pounds and Euros. As a result, future volatility in currency exchange rates would have an adverse effect on our operating results.

We have identified in the past, and may identify in the future, material weaknesses in our internal control over financial reporting, which could damage public perception of our financial statements and cause our stock price to decline.

In the course of preparing our financial statements for fiscal year ended December 31, 2004, we and our auditors identified material weaknesses, as defined in Public Company Accounting Oversight Board Standard No. 2, in our internal control over financial reporting. Specifically, material weaknesses were identified with respect to inadequate preparation and insufficient review and analysis of certain financial statement account reconciliations; lack of documented policies and procedures related to changes and updates in our accounting system; and lack of sufficient personnel with appropriate qualifications and training in certain key accounting roles and adherence to certain control disciplines within the accounting and financial reporting function.

Although we have taken steps to remediate these material weaknesses, we cannot assure you that we will not in the future identify material weaknesses or significant deficiencies in our internal control over financial reporting that we have not discovered to date or that may arise in the future. In such case, we could lose investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our stock price.

<u>Our business could suffer if we are unable to protect and enforce our intellectual property rights.</u>
We rely on a combination of patent, trademark, trade secret laws and contractual restrictions to establish and protect proprietary rights in our products and services. There can be no assurance that our patents, trademarks, or contractual arrangements or other steps taken by us to protect our intellectual property will prove sufficient to prevent misappropriation of our technology or defer independent third party development of similar technologies. Moreover, there can be no assurance that the technology licenses granted to us from our parent company will continue to be available. The loss of any of our proprietary technology could require us to obtain technology of lower quality or performance standards or at greater cost, which could materially adversely affect our business, results of operations and financial condition. Also, competitors may develop their own intellectual property or technologies, obtain their own patents, or challenge the validity of, or be able to design around, our patents. The laws of certain foreign countries may not protect our products, services or intellectual property rights to the same extent as do the laws of the United States.

We may initiate claims or litigation against other third parties for infringement of proprietary rights or to establish the validity of proprietary rights. Similarly, our competitors may initiate claims or litigation against us alleging infringement of their proprietary rights or improper use of their intellectual property. Litigation relating to intellectual property to which we may become a party is subject to numerous risks and uncertainties, including the risk of counterclaims or other litigation against us, and we may not be successful in any such litigation.

<u>Our ability to develop and market our products is dependent upon our retention of certain executive officers and other key personnel.</u>
We are greatly dependent on the ability to retain key management and technical personnel, and our future success is highly dependent upon the personal efforts of our management and technical personnel. The loss of services of any one of them could have a material adverse effect on our business, financial condition, and results of operations. Our success will also be dependent in part upon our ability to attract, retain, and motivate highly skilled employees. We may need to offer additional compensation or incentives to attract and retain these and other employees.

<u>We may need to raise additional capital</u>
It is possible we may need to raise additional funds in the future, and this additional financing may not be available to us in favorable terms, if at all. We may also require additional capital to acquire or invest in complementary businesses or products or obtain the right to use complementary technologies. If we issue additional equity securities to raise funds, the ownership percentage of our existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of our common stock. If we issue debt securities to raise funds, we may incur significant interest expense, which would harm our profitability. The issuance of debt securities may also require us to agree to various restrictions typical of debt securities, including limitations on further borrowing and our right to pay dividends.

<u>Our operations have been and may continue to be negatively impacted by uncertain global economic and political conditions</u>
Our business may suffer as a result of general economic and political conditions in the U.S. and abroad. In 2003 and 2002, there was a rapid and severe downturn in the U.S. market and global

economy. This downturn has been compounded by recent terrorist activity, such as the attacks in the U.S. on September 11, 2001, and the recent military activity in Afghanistan, Iraq and the Middle East. Additional terrorist acts or acts of war could cause damage or disruption to us or to our suppliers and our customers. Fears of global recession, war, and terrorism may continue to have seriously detrimental effects on the U.S. and global economies. Such conditions could further dampen consumer confidence and cause our customers to slow or cease spending on our products. If these events continue, our operations may be negatively impacted.

<u>The seasonality inherent in our business could cause our operating results to fluctuate.</u>
The industrial manufacturing equipment industry in which we compete has historically been subject to seasonality. This is also true with respect to European markets in which we compete where business activity declines due to vacations taken in the summer months. This seasonality, combined with other factors such as the variability in our operating results described above, renders quarter-to-quarter comparisons of our results of operations unreliable as indicia of our overall performance.

<u>Our Parent company has voting control over us.</u>
Approximately eighty-six percent (86%) of our capital stock is currently held by our Parent corporation, Scientific Technology Incorporated, a California corporation. As a result, our Parent has control over matters requiring approval by our shareholders, including the election of directors and the approval of mergers or similar transactions, even if other shareholders disagree. This control, along with provisions of Oregon law affecting acquisitions and business combinations, may delay, deter or prevent a third party from acquiring or merging with us and prevent shareholders from realizing a premium price for their shares associated with an acquisition. This voting control and provisions of Oregon law may also have a negative effect on the market price of our common stock.

<u>Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.</u>

The market risk inherent in our investments represents the potential loss arising from adverse changes in interest rates. We are exposed to market risk in the area of interest rate changes impacting the fair value of our investment securities. Our policy is to invest primarily in money market accounts and short-term investments held at financial institutions. We do not have any derivative instruments in our investment portfolio. Due to their highly liquid nature, our investments are subject to minimal credit and market risk.

<u>Item 4. CONTROLS AND PROCEDURES.</u>

(a) Based on their evaluation as of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2005, our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were not effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. However, due to corrective actions we undertook, including the implementation of certain reporting tools and independent internal reviews of key account reconciliations, our management believes that the financial statements and other financial information included in this quarterly report are complete and accurate in all material respects.

(b) In connection with the audit of our consolidated financial statements for the year ended December 31, 2004, and in light of new, recently issued interpretative guidance in relation to the assessment of the operating effectiveness of a company's internal controls, our management and our independent registered public accounting firm, BDO Seidman, LLP, identified certain "material weaknesses" (as such term is defined under Public Company Accounting Oversight Board Auditing Standard No. 2) in our internal controls.

(c) The material weaknesses identified related to: (1) inadequate preparation and insufficient review and analysis of certain financial statement account reconciliations primarily relating to inventory and accounts receivable valuation; (2) lack of documented policies and procedures related to changes and updates in the accounting system; and (3) lack of sufficient personnel with appropriate qualifications and training in certain key accounting roles and adherence to certain control disciplines within the accounting and financial reporting function. Our management believes that the material weaknesses arose as a result of the Company's significant acquisitions in Logan, Utah and Anaheim, California in recent years.

(d) In response to the material weaknesses in our internal controls over financial reporting identified by our auditors in connection with the audit of our consolidated financial statements for the year ended December 31, 2004, and in preparation for our compliance with Section 404 of the Sarbanes-Oxley Act of 2002, which will be required as of the end of our fiscal year 2007, we commenced during the first quarter of fiscal 2005, and continued during the second and third quarters of fiscal 2005, the following corrective actions to remediate the material weaknesses:

(1) We have implemented additional general ledger close and account analysis procedures including procedures to analyze consolidated fluctuations and reporting. These procedures also include analysis of inventory and accounts receivable aging and valuation.

(2) We are working with advisors to help establish policies and procedures related to changes and updates in our accounting system; and

(3) We have begun a process to address our need for additional experienced finance personnel in order to improve our controls over financial reporting.

We intend to continue to evaluate the remediation efforts addressing the material weaknesses that were identified and to take appropriate action to correct the deficiencies identified, and to continue to review, evaluate and strengthen our controls and processes. The Audit Committee of our Board of Directors is performing oversight of our implementation of enhancements and improvements to our internal control over financial reporting, and our management is reporting to our Audit Committee on a regular basis regarding these matters.

PART II - OTHER INFORMATION

Items 1 through 5 are not applicable for this reporting period.

Item 6. EXHIBITS.

The following documents are filed as a part of this Report:

Exhibit 31 - Section 302 Certification of Chief Executive and Chief Financial Officers

Exhibit 32 - Section 906 Certification of Chief Executive and Chief Financial Officers

SIGNATURES

Pursuant to the requirements 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.

SCIENTIFIC TECHNOLOGIES INCORPORATED
Registrant

Date: November 14, 2005

/s/Joseph J. Lazzara
Joseph J. Lazzara
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 14, 2005

/s/ Richard O. Faria
Richard O. Faria
Vice-President and Chief Financial Officer
(Principal Financial Officer)