2001 Shareholder Information Packet

KEY TECHNOLOGY, INC.

To Our Shareholders,

For Key Technology, fiscal 2001 was one of the most difficult and challenging years in the Company's long history. We experienced a significant downturn in our markets, faced uncertain economic conditions, and completed the large and complex integration of the Advanced Machine Vision Corporation (AMVC) acquisition.

As the year progressed and the business climate degraded, we implemented specific actions that had one clear objective – to reposition the business for a return to profitability. These actions, which will be discussed below, were necessary to secure the Company's future success and keep Key healthy in this challenging environment.

Fiscal 2002 is a year of opportunity and the entire Key Technology team is dedicated to achieving positive financial results. We remain focused on providing superior products and services to our customers while controlling costs, improving our operations and investing in our future. We believe that the business adjustments made in 2001 will result in significant improvements to results for 2002.

Financial Results

While we benefited from a full year of the AMVC acquisition, we ended the year with a net loss. No one is more disappointed in the Company's 2001 financial results than our management team.

The reported net loss for the year was $4.9 million, or $1.24 per diluted share, on revenues of $73.0 million. The net loss consists of $2.3 million in operating losses from continuing operations, $436,000 of operating losses from discontinued operations, and a $2.1 million loss resulting from the sale of Ventek.

Focus on Operations

As our business has grown, both organizationally and geographically, the responsibilities and time commitment required to effectively manage the Company's operations and future strategic direction have also grown. As a result, in February 2001, the position of President and C.O.O. was established with a primary focus on day-to-day operations. This change allows critical focus on both the execution of our current operational plans and a long-term focus on strategic initiatives.

By the beginning of the first quarter of 2001, we were experiencing the effects of a significant decline in the purchase and sale of capital equipment. Our customers were affected by rising energy costs, a slowing economy in both the U.S. and Europe, and interest rates that had increased to their highest levels since 1991. As a result, anticipated capital equipment purchases were delayed, including several large projects in the french fry industry.

At the beginning of our second quarter, the Federal Reserve Board made the first of a record number of interest rate reductions that took place during 2001, making it easier for our customers to justify new capital expenditures. Although we have seen some positive indicators, the interest rate cuts had not yet spurred a significant increase in investments by our customers at year-end. This delayed reaction is consistent with prior trends in our markets and we expect to see the positive effects of the lower interest rates in future financial results.

During the year, we made a number of business adjustments as we responded to the changing economic climate. We moved the manufacturing of our SRC Vision product line, acquired in the AMVC merger, from Medford, Oregon to our headquarters in Walla Walla, Washington, resulting in reduced manufacturing costs and better utilization of our assets. We implemented stringent controls on capital spending, substantially reduced our workforce, selectively reduced expenses in research and development and sales and marketing programs, and aggressively pursued reductions in manufacturing costs for our product lines.

We have worked hard to streamline operations, and our dedicated and committed workforce continues to focus on reaching higher levels of efficiency and customer satisfaction. We are confident that we have realigned our business with the realities and opportunities of the current business environment.

Customer and Market Leadership

Customer satisfaction is a core value at Key Technology and our commitment to customers is as great as our commitment to financial success. We are the market leader in most segments that we serve and have earned that position by listening to the needs of our customers and solving their complex problems with technologies that add value to their operations.

During fiscal 2001 we introduced Optyx®, an economical, compact optical sorter that offers the same power and sorting capabilities of large-scale automated inspection systems, such as our Tegra® and Prism® products. This low-cost sorter is ideal for smaller processors and lower volume processing lines and allows the production of higher quality product at low operating costs. The addition of Optyx to our family of optical products gives Key a sorter solution for a broad spectrum of customer needs and product applications that will allow us to further strengthen our position in the sorter market.

While we continue to invest in the development of new products, we are also investing in the development of new markets. This year we successfully expanded our sales into dry product markets including snack foods, cereal, and pet foods, resulting in a 105% increase in revenues in these markets compared to the prior year. The opportunity for further success in these markets is notable and we will continue to build on our customer relationships and market position in 2002.

Our strategy for geographic expansion into the Asia-Pacific region is also beginning to pay off. In 2001, we achieved significant revenue growth in China and Japan, driven mainly by sales of sorting systems to tobacco processors. We established a sales office in Australia, enabling Key to provide better sales and service support for our existing customer base and to aggressively pursue new business in Australia's $50 billion food processing industry. We are making prudent investments aimed at further development of our market channels in this region and are positioning ourselves to take advantage of the growing economies of the Asia-Pacific marketplace.

As our customers decreased their capital expenditures in 2001, they increased investment in parts and upgrades for their existing equipment. We also began to reap the benefits of a larger installed base of optical equipment that resulted from our acquisition of AMVC. As a result, orders for Parts and Service grew by 25% over the prior year. In 2002, we will aggressively market our expanding service offerings designed to ensure equipment longevity, prevent downtime, protect budgets, and maximize return on investment for our customers.

Financial Fortitude

While we were disappointed in our financial results for the year, we did make progress in several financial metrics during fiscal 2001. We aggressively sought to improve working capital through better management of inventories, accounts payable and accounts receivable, which enabled us to generate net cash of $2.8 million from operations and reduce our debt level by $2.6 million. Debt reduction was, and continues to be, a focus for us.

We redeemed warrants and Series C convertible preferred stock totaling $4.5 million and also reduced our potential redemption obligation by an additional $2.0 million as a result of the sale of Ventek.

In order to achieve our financial targets for 2002, we will be aggressively managing costs and focusing on cash. We will build on our 2001 initiatives to reduce our investment in working capital, limit capital spending, and carefully discipline ourselves on operating expenses. These actions are designed to deliver stronger cash flow and contribute to reduction in corporate debt. We should see positive results from these efforts in 2002.

As the U.S. economy strengthens, we believe that the organization and business plan that we established in 2001 will put us in the position to take advantage of the opportunities that arise.

Dedication to Future Success

Throughout these challenging times, we want you to know that Key Technology remains commited to customer satisfaction, profitability, cash generation and shareholder value. We are confident that we have created a roadmap for the future that will produce renewed, sustainable earnings growth in 2002 and beyond.

Key Technology has excellent products, an established multinational customer base, a solid leadership position in our markets and a team of employees that is absolutely dedicated to the financial success of our Company.

We are keenly focused on the year ahead and look forward to reporting to you on our progress in next year's report. We are grateful for the support of our shareholders, the loyalty of our customers and the dedication of our employees.

Sincerely,

Thomas C. Madsen
Chairman and Chief Executive Officer

Kirk W. Morton
President and Chief Operating Officer

Directors and Officers

THOMAS C. MADSEN
Chairman of the Board and
Chief Executive Officer

HAROLD R. FRANK [1, 2]
Director
Chairman Emeritus,
Applied Magnetics Corporation

RODNEY W. LARSON
Vice President of SRC Vision and
Vice President of Service

JOHN E. PELO [1]
Director
President and Chief Executive Officer,
Swire Pacific Holdings, Inc.

KIRK W. MORTON
President and Chief Operating Officer

TED R. SHARP
Chief Financial Officer

MICHAEL L. SHANNON [2]
Director
Chairman and Chief Executive Officer
Data Access Technologies, Inc.

PETER H. VAN OPPEN [1]
Director
Chairman of the Board and
Chief Executive Officer,
Advanced Digital Information Corp.

GORDON WICHER
Secretary
Vice President of Operations

[1] Member of the Audit Committee of the Board of Directors
[2] Member of the Compensation Committee of the Board of Directors

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Shareholder Information

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Stock Listing

Key Technology, Inc. common stock trades on the Nasdaq National Market under the symbol KTEC.

Form 10-K

The company files an annual report with the Securities and Exchange Commission on Form 10-K, pursuant to the Securities Exchange Act of 1934. Additional copies of the Company's Form 10-K may be obtained without charge by contacting the Investor Relations Department.

Comments included in this document may include "forward-looking statements" within the meaning of the federal securities laws, including statements as to anticipated future results that are based on current expectations and subject to a number of risks and uncertainties. It is important to note that the Company's actual results could differ materially from those projected in such forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those in forward-looking statements is contained from time to time in the Company's SEC filings, including, but not limited to the Company's report on Form 10-K for the year ended September 30, 2001.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549-1004

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the fiscal year ended September 30, 2001

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 No. 0-21820

KEY TECHNOLOGY, INC.
(Exact name of Registrant as specified in its charter)

OREGON	93-0822509
(State of Incorporation)	(I.R.S. Employer Identification No.)
150 Avery Street, Walla Walla, Washington	99362
(Address of principal executive offices)	(Zip Code)

(509) 529-2161
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
None
Securities registered pursuant to Section 12(g) of the Act:
Common Stock, no par value
Series B Convertible Preferred Stock, par value $.01 per share
Warrants to purchase Common Stock, dated July 12, 2000

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

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

The aggregate market value of the Registrant's common stock held by non-affiliates on December 18, 2001 (based on the last sale price of such shares) was approximately $12,828,634.

The number of shares of the Registrant's common stock outstanding on December 18, 2001 was 4,751,346 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of Registrant's Proxy Statement dated on or about January 30, 2002 prepared in connection with the Annual Meeting of Shareholders to be held on February 20, 2002 are incorporated by reference into Part III of this Report.

KEY TECHNOLOGY, INC.
2001 FORM 10-K
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PART I

Certain statements set forth below may constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements to differ from those expressed or implied by the forward-looking statements. With respect to the Company, the following factors, among others, could cause actual results or outcomes to differ materially from current expectations:

- the Company's inability to meet its potential equity redemption obligations in July 2002 when it may be required to redeem for cash all or a portion of its outstanding preferred stock or at any time when it may be required to redeem certain warrants;
- the effect of the Company's substantial debt on its operations and future growth;
- the Company's inability to obtain additional financing in the future;
- the effect on the Company's business of adverse economic conditions in the food processing industry and other industries served by the Company;
- the performance and needs of industries served by the Company and the financial capacity of customers in these industries to purchase capital equipment;
- the ability to achieve revenue growth;
- the ability of new products to compete successfully in either existing or new markets;
- competitive factors;
- the risks involved in expanding international operations and sales;
- achievement of product performance specifications and any related effect on product upgrade or warranty expenses;
- the potential for adverse fluctuations in foreign currency exchange rates;
- the effect of product or market development activities;
- availability and future costs of materials and other operating expenses;
- uncertainties relating to patents and proprietary information;
- the potential for patent-related litigation expenses and other costs resulting from claims asserted against the Company or its customers by third parties; and
- other factors discussed in Exhibit 99.1 hereto which is incorporated herein by reference.

Given these uncertainties, readers are cautioned not to place undue reliance on the forward-looking statements. The Company disclaims any obligation subsequently to revise or update forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

ITEM 1. BUSINESS.

General

Key Technology, Inc. (the "Company") was founded in 1948 as a local producer of vegetable processing equipment and has evolved into a worldwide supplier of process automation solutions to the food processing industry and other industries such as tobacco, plastics and pharmaceuticals. The present Company was incorporated in 1982 as a result of a management buyout of the predecessor organization.

The Company and its operating subsidiaries design, manufacture, sell and service process automation systems that process product streams of discrete pieces to improve safety and quality. These systems integrate electro-optical automated inspection and sorting systems with process systems which include specialized conveying and preparation systems. The Company provides parts and service for each of its product lines to customers throughout the world. Industries served include food processing and non-food and industrial applications such as tobacco, plastics, and pharmaceuticals.

During fiscal 2001, the Company's net sales were $73.0 million compared to sales of $67.4 million in fiscal 2000. The Company incurred a net loss of $4.9 million, or $1.24 per share, for the year ended September 30, 2001, which included merger-related amortization and non-recurring integration costs of $3.4 million, or $2.1 million after tax, and the loss on the sale of Ventek of $2.1 million. Excluding these merger-related and non-recurring integration costs, as well as the loss on the sale of Ventek, the net loss would have been $643,000, or $0.33 per diluted share. The loss for fiscal 2001 compares with a reported net loss of $333,000, or $0.12 per diluted share, for fiscal 2000, which included merger-related and one-time acquisition costs of $3.0 million or $1.9 million after tax. Excluding merger-related and one-time acquisition charges, net earnings would have been $1.6 million or $0.29 per diluted share for the year ended September 30, 2000.

The Company acquired two separate organizations during fiscal 2000. On June 1, 2000 the Company acquired Farmco, Inc. and its sister company Ro-Tech, Inc. (collectively "Farmco"). Both companies are based in Redmond, Oregon. Farmco manufactures and sells equipment that mechanically sorts, grades, selects, or removes product based upon its size or shape. Ro-Tech, Inc. performed research and development activities for Farmco products and owned the intellectual property associated with Farmco products. On July 12, 2000 the Company acquired Advanced Machine Vision Corporation (AMVC), a company based in Medford, Oregon. AMVC and its subsidiaries design, manufacture and market machine vision systems that combine lighting, camera, processor and software technologies to improve quality, enhance yield, reduce production costs and increase throughput in a variety of markets. Applications include systems for the food, tobacco, plastics recycling, pulp wood, and wood panel industries.

Prior to September 30, 2001, the Company committed to a plan to sell Ventek, Inc. ("Ventek"), a wholly-owned subsidiary that supplies machine vision systems to the forest products industry. Ventek was acquired by Key as part of its acquisition of AMVC in July 2000.

The Company's domestic operations are headquartered in Walla Walla, Washington with manufacturing facilities in Walla Walla, Washington and Redmond, Oregon. The Company moved the manufacturing activities acquired from AMVC from Medford to Walla Walla in fiscal 2001, but continues to maintain a presence in Medford performing research and development, service and sales activities. The Company supplies all product groups - automated inspection systems and process systems - to customers in its primary markets through common sales and distribution channels. In addition, the Company supplies parts and service through its worldwide service organization.

Industry Background

The Company considers the size and variety of worldwide processing industries to be a significant opportunity for growth, not only to solve existing quality and safety issues, but also to assist in providing safe processing technologies to expanding global markets. Accordingly, the Company devoted increased resources in fiscal 2001 to selling and marketing activities and new product research and development that will increase the Company's ability to address these potential global markets.

Food Processing Industry

Food processors must process large quantities of raw product through different stages, including sorting to remove defective pieces and inspection for product quality and safety. The frequency and severity of defects in the raw product is highly variable depending upon local factors affecting crops. Historically, defect removal and quality control in the food processing industry have been labor intensive and dependent upon and limited by the variability of the work force. The industry has sought to replace manual methods with automated systems that achieve higher yield, better product quality and safety and reduced cost.

The Company's strategy is to solve processing industry problems of high labor costs, inadequate yields and inconsistent quality and safety by providing automated inspection systems and process systems. The Company's process automation systems use advanced optical inspection technology to improve product yield (more of the good product recovered) and quality (higher percentage of defective product being removed) over the manual sorting and defect removal methods historically used by food processors. In a typical application, process automation systems can replace 25 to 75 processing line employees, resulting in labor cost savings and improved yield sufficient to pay for the system in less than one year, as well as providing significant improvements in product quality.

The global food processing industry is currently in a consolidation period and is facing low single-digit growth rates. Market conditions may point to further consolidations in the future. The consolidations in the food processing industry have resulted in Key's customers delaying investment in it's products. Key believes the food processing companies that emerge from this consolidation period will be financially stronger, however these surviving companies will be looking for ways to improve product quality and safety, as well as ways to make themselves more competitive. Since Key's equipment results in higher product yields, improved product quality and safety, as well as reduced processing costs, Key believes these surviving companies will have more interest in its products allowing for expanded sales into this industry in future years.

Non-food Industries – Tobacco, Pharmaceuticals & Plastics

Processors in non-food industries are also implementing systems solutions to reduce costs, increase yields, and produce higher quality products that are safe for consumers.

The largest non-food processing market is the tobacco industry. With the acquisition of AMVC and its subsidiary SRC Vision, which has an installed base of over 100 units in the tobacco industry, the Company significantly increased its potential opportunities in this market and may be able to introduce other products along with automated inspection systems to tobacco customers. At present, the pharmaceutical, plastics and other non-food industries represent a relatively small share of the Company's sales and installed base. However, to further its growth strategy, the Company is actively pursuing expansion into new markets, some of which have the potential for higher profit margins. The Company believes that many additional applications for its products exist in both food and non-food markets, particularly in the area of automated process control.

Products

The Company has developed a modular family of product lines that can be configured in a variety of ways and integrated to provide complete solutions for specific applications. Advances in any one module can therefore benefit a number of the Company's products. Despite the incorporation of sophisticated technology, the Company's products can be operated by plant personnel with minimal specialized training and are built to withstand the harsh environments found in processing plants.

The following table sets forth sales by product category for the periods indicated:

	Fiscal Year Ended September 30,		
	2001	2000	1999
		(in thousands)	
Automated inspection systems	$26,884	$24,002	$22,342
Process systems	27,050	26,414	33,950
Parts and service/contracts	19,020	16,996	13,239
Net sales	$72,954	$67,412	$69,531

Service and maintenance contracts are less than 10% of total net sales and therefore are summarized with parts.

The following table sets forth the percent of the total gross margin contributed by each product category for the periods indicated:

	Fiscal Year Ended September 30,		
	2001	2000	1999
Automated inspection systems	39%	40%	39%
Process systems	32%	28%	41%
Parts and service/contracts	29%	32%	20%
Total gross margin	100%	100%	100%

Automated Inspection Systems

Automated inspection systems are used in various applications to detect and eliminate defects, most often during processing of raw products. The Company's systems within this group include the ADR® and Tegra® systems, representing the fourth generation of automated inspection systems designed by Key Technology; Prism® and Tobacco Sorter II™ and Tobacco Sorter 3™ designed by SRC Vision; and the new Optyx™ automated inspection system, designed by the merged companies. All systems are now manufactured at the Walla Walla manufacturing facility.

Nearly all systems in this group use proprietary linear array charged coupled device ("CCD") mono-chromatic, color or multi-spectral cameras. Each of the cameras scan the product-streams, which move at 5 to 20 feet per second, at the rate of 1,500 to 4,000 times per second and can identify defects as small as 1/16 of an inch (1.5 mm) in diameter. Systems with monochromatic cameras generally are sold at lower price levels and are most effective for product that has a marked disparity in shade between the defective and the good product. Systems with color cameras are required when a variety of defect and product colors occur simultaneously or when the difference in shading between the defective and the good product is more subtle. In 1998, the Company developed multi-spectral systems which utilize either infrared or ultraviolet technologies, individually or in combination with visible light, to identify defects that may not be detectable by using solely visible light spectra.

Tegra System. In fiscal 1996, the Company introduced its fourth generation of automated inspection system sorters. Named Tegra, this generation of automated inspection systems incorporates a number of technological and mechanical advances that result in significant improvements to processing efficiency and product throughput with higher recovery and defect-removal rates. Certain present and potential applications for Tegra systems include potato products, green beans, dried beans, corn, carrots, peas, spinach and other leafy vegetables, pears, nuts, grains, coffee and tobacco.

Tegra incorporates object-specific IntelliSort™ technology. IntelliSort sorting technology recognizes not only color and size, but also shape. This capability provides a solution to previously difficult sorting problems, such as differentiation between green beans and green bean stems. Tegra cameras are capable of high fidelity color-image processing to scan product at a rate of over 4,000 times per second, offering a sensitivity to color subtleties beyond human vision. Tegra also incorporates KeyWare® software that substantially reduces operational complexity. KeyWare consists of application packages, each specifically designed for a single product category that, together with the system's computer hardware capability and networking software, support all standard factory control and automation interfaces. These features allow Tegra to establish data connectivity and communication with a processing plant's computer network system.

Prism System. In 1999, SRC Vision introduced the new Prism sorting system. Designed for stable performance in challenging environments, Prism has gained strong acceptance in segments of the fruit, vegetable and snack food markets. It incorporates optional sensing of short-wave infrared light, uses a novel broad-band illumination system, and is designed to require minimal maintenance. In addition to present and potential applications in potato products, vegetables, fruits, plastics, and snack foods, Prism adds specific applications with products such as dehydrated potato flakes, plastic flake and peaches.

Prism incorporates a new image processing module, the "Advanced Vision Processor" ("AVP™"). Introduced concurrently with Prism, AVP uses a high speed serial processor to convert color camera signals into product separation actions. It incorporates the latest in high frequency bus architecture, and incorporates cameras that have eight times the color resolution of previous generations. Designed for flexibility, AVP is comprised of modules that provide an on-going upgrade path, minimizing sustaining development costs, and maximizing the effective life of the design. AVP uses a powerful combination of a high speed "super-pipelined" sorting engine with a Windows NT-based user interface. An internal communication network enables detailed self-diagnosis to be performed on many system components.

Tobacco Sorter II and Tobacco Sorter 3. The tobacco industry has special requirements in the handling and sorting of its tobacco products, which vary in size and moisture content and other properties depending upon the type of product being produced and the point of handling and inspection. SRC Vision's Tobacco Sorter 3 (TS3), introduced worldwide in 2001, utilizes the machine vision engine of the Prism System in a specially constructed frame, enclosure, and material handling arrangement to meet the specific product inspection requirements of this industry. In addition to the large installed base of its predecessor, Tobacco Sorter II, the new TS3 has now been installed successfully in North America, Latin America, Europe and Asia. Customers have benefited from

TS3's improved color resolution, significantly enhanced data communications capability, and reduced maintenance requirements.

Optyx System. In fiscal 2001, the company developed and introduced its new automated inspection system named Optyx. The Optyx system was developed by the combined research and development organizations of Key Technology and SRC Vision. The new sorter incorporates the best technologies of both companies to create a sorter that maintains the power and sorting capabilities of a large sorter in an economical and compact machine. Optyx employs the advanced camera, lighting, image processing, and ejection technologies used in the Tegra and Prism products. The lower cost Optyx system is ideal for smaller processors and lower volume processing lines which were previously unable to justify the expense of a larger sorter. Present and potential applications include the Company's traditional fruit, vegetable and tobacco markets. The Optyx system has successfully proven its technical capabilities at several beta site locations and the Company has received orders for several Optyx systems.

ADR System. The Company's ADR systems are used to transport, inspect and remove defects from french fry potatoes. The Company believes its ADR system is the principal optical inspection and defect removal system used in the french fry processing industry. The Company's full-capacity ADR systems can process up to 27,000 pounds of product per hour.

Pharmaceutical Inspection System. In fiscal 1996, the Company purchased certain inventory, trademarks and patents related to a pharmaceutical inspection product line, the I-300 Pharmaceutical Inspection System, from the Imaging Division of Oncor, Inc. Using patented spatial color analysis technology, this product line inspects solid-dose pharmaceuticals, including tablets, capsules and softgels for broken or missing pieces, foreign products, discoloration or coating defects, as well as the integrity of capsules. The pharmaceutical inspection system also verifies and detects color, size, location and shape defects at processing rates over one million pieces per hour. Sales of this product line are a minor contributor to automated inspection system revenues.

Process Systems

Conveying and other custom designed processing systems are utilized throughout the food industry, as well as other industries, to move large quantities of product within a processing plant. The Company's process systems include the Iso-Flo®, Horizon™, Marathon™, and Impulse™ vibratory conveyor systems. The Farmco acquisition added another significant product group, that is made up of mechanical sizing, sorting, separating and grading equipment. In addition, the product line includes food pumping systems, belt conveyors, spiral elevators and other custom designed conveying technologies.

Iso-Flo Vibratory Conveying Systems. The Company's principal specialized conveying system is its Iso-Flo vibratory conveyor system, which was introduced in 1978. The Iso-Flo conveyor is a type of pan conveyor. Pan conveyors are common throughout industries that process product streams of discrete pieces, especially the food processing industry. Pan conveyors move product pieces by vibrating the pan at high frequency along a diagonal axis, upward and forward. This action propels the product ahead in small increments and distributes it evenly for close control of movement and presentation.

Iso-Flo systems are used in a variety of processing applications, including potato products, vegetables and fruits (green beans, peas, carrots, corn, peaches, pears, cranberries and apples), snack foods, cereals, pet foods, poultry, seafood and certain nonfood products.

Most Iso-Flo conveyors are custom designed and engineered by the Company to customer specifications. The Company considers its vibratory conveyor technology to be a proprietary core competency. As a result of the Company's research and development activities in fiscal 1999 and 2000, it expanded its family of vibratory conveyors with the introduction of three new products in the first quarter of fiscal 2000. These products were the Horizon™, the Impulse™ and the Marathon™ conveying systems. Initial placements of beta and trial units were made in fiscal 2000 which resulted in initial sales of all the new products during fiscal 2001. Product reliability and performance met expectations in all placements with order and quote volume increasing. During fiscal 2001, activity in research and development focused on product enhancement options, including new automated diverters for product movement, vibration sensors, and added automation and control technologies for all process systems.

The Horizon is a horizontal motion vibratory conveyor that uses a gentle conveying action to move fragile foods, such as snacks, cereals and seasoned/coated products, through the processing stages. The design of the Horizon eliminates vertical bounce of the processor's product. This feature results in reduced costs to the processor due to minimized product damage, reduced seasoning/coating loss and elimination of condiment build-up on the conveying surface.

The Impulse is a line of electromagnetic conveyors which combine the advantage of quick start/stop with precise metering control. Additionally, the Impulse conveyor drive systems are oil-free which limits the potential for contamination and improves the safety of edible food products. This conveyor system was developed for packaging applications in snack food, dry ingredient, chemical and pharmaceutical processing.

The Marathon is the Company's longest conveyor and moves product up to 100 feet or more on a single conveyor bed. This conveyor is targeted for use in high volume applications such as corn, green beans and other bulk conveying markets to maximize the processor's production efficiency.

The mechanical sizing, sorting, separating, and grading products are used in many food processing systems. These proprietary rotary sizing and grading technologies optimize yield, increase packaging efficiency, and improve product quality primarily by removing small irregular-shaped pieces of product from the line or separating product into predetermined size categories. In combination with other Company provided equipment, these products can increase overall line efficiency and systems capability.

Food Pumping Systems and Belt Conveyors. The Company's hydro food pumping systems are used to transport food items over distances and elevations in processing plants. A typical pumping system consists of a stainless steel contoured tank and food pump to propel the product through lengths of piping to a water removal/product spreading subsystem. The systems can be configured so that food processing functions, such as blanching, cooling and cutting, can also occur during pumping. The Company also designs and manufactures belt conveyors using a variety of belt materials and frame configurations.

Preparation systems. The Company designs and manufactures raw food preparation systems to prepare vegetables prior to freezing, canning or other processing. Products in this group include blanchers, air cleaners, air coolers, froth flotation cleaners, vegetable metering systems, and bulk handling equipment. These products represent the Company's most mature product line. Sales of these products over the years have formed a customer base for sales of other Company products and are also establishing a customer base in markets in developing countries.

Preparation system revenues may also include a variety of third-party supplied equipment and installation services which are sold as components of larger processing lines, for which the Company has assumed turn-key sales responsibility. In fiscal 2001, the Company did not sell any third-party products for which it assumed turn-key sales responsibility. In fiscal 2000, these third-party supplied products accounted for approximately $1.8 million of the $26.4 million total net sales of process systems.

Parts and Service/Contracts

The Company provides spare parts and post-sale field and telephone-based repair services to support its customers' routine maintenance requirements and seasonal equipment startup and winterization processes. In response to increasing customer demand for maintenance and parts services, the Company introduced a new multi-tier service product offering named UpTime™ in fiscal 1999. During fiscal 2000 the Company tested the ability to supply remote diagnostics in the UpTime™ offering and began selling this service as UpTime Connection in Fiscal 2001. The Company considers its parts and maintenance service sales to be important potential sources of future revenue growth. In fiscal 2001, to help increase parts and maintenance service revenues and provide a higher level of customer service, the Company realigned its service organization so that field service personnel are now geographically located closer to its customers throughout the world. The Company also typically provides system installation support services which are included in the sales price of certain of its products, principally automated inspection systems.

Customers and Markets

The Company's primary market is the food processing industry. The largest markets for the Company's products have been processors of potatoes, vegetables and snack foods. The Company has also experienced recent success in the dry product markets which include cereals and pet food. The Company believes many additional applications for its systems exist in both food and non-food markets.

The principal potato market served by the Company's systems is french fries. French fries comprise approximately 90% of the over eight billion pounds of frozen potato products processed annually in the United States. The expansion of American-style fast food chains in other countries is resulting in parallel development of the frozen french fry market overseas. The major investment in new french fry processing facilities is occurring outside the United States.

The Company's products are used in the fruit and vegetable processing market where field-harvested products are cleaned, graded, automatically sorted, blanched and processed prior to freezing, canning or packaging for sale to institutional and retail markets. Principal fruit and vegetable market segments for the Company are green beans, corn, carrots, peas, onions, apples, pears, cranberries and peaches.

In non-food markets, the Company's principal market is the tobacco industry. The Company's products provide tobacco companies sorting capability to remove impurities and foreign matter from a stream of stripped tobacco. The Company believes market growth for tobacco systems shows great promise based upon the high degree of acceptance demonstrated by its customers and the significant size of the worldwide tobacco processing market. Additionally, the Company expects that the tobacco market may provide opportunities for expanded sales of process systems to compliment new and existing installations of automated inspection systems.

Export and international sales for the fiscal years ended September 30, 2001, 2000 and 1999 accounted for 49%, 41% and 46% of net sales in each such year, respectively. Nearly all export sales of products manufactured in the United States for shipment into international markets other than Europe have been denominated in U.S. dollars. Sales into Europe of systems, spare parts and service, as well as products manufactured in Europe, are generally denominated in European currencies. In its export and international sales, the Company is subject to the risks of conducting business internationally, including unexpected changes in regulatory requirements; fluctuations in the value of the U.S. dollar, which could increase the sales prices in local currencies of the Company's products in international markets; tariffs and other barriers and restrictions; and the burdens of complying with a variety of international laws. Additional information regarding export and international sales is set forth in Note 13 to the Company's Consolidated Financial Statements for the year ended September 30, 2001.

During fiscal 2001, 2000 and 1999 sales to McCain Foods represented approximately 17%, 14% and 11% of total net sales, respectively. While the Company believes that its relationship with McCains is satisfactory, the loss of this customer could have a material adverse effect on the Company's results of operations.

The Company markets its products directly and through independent sales representatives. In North America, the Company operates sales offices in Walla Walla, Washington; Medford, Oregon; and Redmond, Oregon. The Company's subsidiary, Key Technology B.V., provides sales and service to European customers.

Engineering, Research and Development

At September 30, 2001, the Company's engineering departments had 115 technical and support employees who conduct new product research and development, sustaining engineering for released products and project engineering for custom systems. The department includes electronic, mechanical and software engineers, mathematicians and technical support personnel.

The Company's project engineering teams are responsible for engineering and designing the details of each custom order. A document control team maintains and controls product documentation and the product modeling database for the development engineering and project engineering teams as well as the manufacturing department.

In fiscal 2001, the Company's engineering, research and development expenses were approximately $5.4 million, compared to $5.3 million and $4.3 million in 2000 and 1999, respectively.

Manufacturing

The Company maintains three domestic manufacturing facilities, two located in Walla Walla and one in Redmond, Oregon, and a European manufacturing facility located in The Netherlands. The Company's current manufacturing facilities and its product design and manufacturing processes integrate Computer Aided Engineering (CAE), Computer Aided Design (CAD), Computer Aided Manufacturing (CAM) and Computer Integrated Manufacturing (CIM) technologies. Manufacturing activities include process engineering; cutting, welding, fabrication and assembly of custom designed stainless steel systems; camera and electronics assembly; subsystem assembly; and system test and integration. The Company manufactures products in the following locations:

Location	Size in Square Feet	Products/Services Produced
Walla Walla, Washington	150,000	Automated Inspection Process Systems Parts and Service
Walla Walla, Washington	100,000	Process Systems
Redmond, Oregon	19,000	Process Systems Parts and Service
Beusichem, The Netherlands	45,000	Process Systems Parts and Service
Beusichem, The Netherlands	18,000	Parts warehouse Future manufacturing expansion

The Company manufactures certain of its products to Underwriters Laboratories, United States Department of Agriculture and Occupational Safety and Health Administration standards. The Company's domestic manufacturing processes in its Walla Walla operations originally became qualified in January 1995 for certification to the ISO-9001 quality management and assurance standards. Those specific operations were audited in fiscal 2001 and found to be compliant. The processes of qualifying and certifying the Company's Redmond, Oregon operations and the engineering and service operations in Medford, Oregon is currently under review. It is the Company's expectation that each of those entities will become certified to the ISO-9001 quality standard. Certain of the Company's products also comply with the Canadian Standards Association (CSA), European CE (Conformité Européene) and Electronic Testing Laboratory (ETL) safety standards.

Certain components and subassemblies included in the Company's products are obtained from single-source or sole-source suppliers. The Company attempts to ensure that adequate supplies are available to maintain manufacturing schedules. Although the Company seeks to reduce its dependence on sole and limited source suppliers, the partial or complete loss of certain sources of supply could have an adverse effect on the Company's results of operations and relations with customers.

Backlog

The Company's backlog as of September 30, 2001 and September 30, 2000 was approximately $12.5 million and $14.1 million, respectively. Gross shipments exceeded orders by $1.6 million in fiscal 2001. The Company schedules production based on firm customer commitments and forecasted requirements. The Company includes in backlog only those customer orders for which it has accepted purchase orders. However, the Company believes that backlog is not necessarily a meaningful indicator of future financial results as it typically ships products ordered within eight to thirteen weeks from the date of receipt of the order. Large multiple-unit system orders or orders for systems in high demand may, however, result in longer delivery times.

Competition

The markets for automated inspection systems and process systems are highly competitive. Important competitive factors include price, performance, reliability, and customer support and service. The Company believes that it currently competes effectively with respect to these factors, although there can be no assurance that existing or future competitors will not introduce comparable or superior products at lower prices. Certain of the Company's competitors may have substantially greater financial, technical, marketing and other resources. The Company's principal competitors are believed to be FMC Technologies, Inc., Heat & Control, Sortex Ltd., the Pulsarr B.V. and Elbicon N.V. subsidiaries of Barco N.V., Kiremko B.V., and BEST N.V. As the Company enters new markets, it expects to encounter new niche competitors.

Patents and Trademarks

The Company currently holds fifty-seven active United States patents issued from 1984 through 2001 and twenty-three active patents issued by other countries, the first of which expires in calendar 2002. As of December 18, 2001, twenty-two other patent applications had been filed and are pending in the United States and other countries. The Company has twenty-three registered trademarks and applications pending for three trademarks.

The Company also attempts to protect its trade secrets and other proprietary information through proprietary information agreements and security measures with employees, consultants and others. The laws of certain countries in which the Company's products are or may be manufactured or sold may not protect the Company's products and intellectual property rights to the same extent as the laws of the United States.

Employees

At September 30, 2001, the Company had 543 full-time employees, including 230 in manufacturing, 115 in engineering, research and development, 136 in marketing, sales and service and 62 in general administration and finance. A total of 112 employees are located outside the United States. None of the Company's employees in the United States are represented by a labor union. The manufacturing employees located at the Company's facility in Beusichem, The Netherlands are represented by the Small Metal Union. The Company has never experienced a work stoppage, slowdown or strike. The Company considers its employee relations to be excellent.

ITEM 2. PROPERTIES.

The Company owns or leases the following properties:

Location	Purpose	Square Feet	Owned or Leased	Lease Expires	Renewal Period
Walla Walla, Washington	Corporate office, manufacturing, research and development, sales and marketing, administration	150,000	Leased with option to purchase within the lease term	2010	
Walla Walla, Washington	Manufacturing, research and development, sales and marketing	100,000	Leased with option to purchase beginning January 1, 2002	2005	2010
Medford, Oregon	Research and development, sales and marketing (1)	82,000	Owned (2)		
Medford, Oregon	Vacant Lot	50,000	Owned (3)		
Redmond, Oregon	Manufacturing, research and development, administration	19,000	Leased	2003	2008
Beusichem, The Netherlands	Manufacturing, sales and marketing, administration	45,000	Leased	2008	2013
Beusichem, The Netherlands	Parts warehouse, future manufacturing expansion	18,000	Owned		

(1) In fiscal 2001 the manufacturing activities previously performed in Medford were moved to the Company's 150,000 square foot facility in Walla Walla. The Company has offered for sale its partially-vacant Medford facility.

(2) Subject to a deed of trust securing an approximately $2.9 million loan made by Bank of America National Trust and Savings Association. The loan bears interest at 8.3% and is due May 1, 2008.

(3) The Company originally acquired 150,000 square feet of vacant land in conjunction with the acquisition of AMVC. Subsequently, the Company has sold 100,000 square feet to various third parties. Based upon these transactions and the number and quality of continuing inquiries, the Company expects to sell the remaining property at or above its book value.

ITEM 3. LEGAL PROCEEDINGS.

From time-to-time, the Company is named as a defendant in legal proceedings arising out of the normal course of its business. As of December 5, 2001, the Company was not a party to any material legal proceedings.

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

None.

PART II

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

Common Stock

Shares of the Company's common stock are quoted on the Nasdaq National Market System under the symbol "KTEC". The following table shows the high and low bid prices per share of the Company's common stock by quarter for the two most recent fiscal years ended September 30:

	High	Low
Fiscal 2001		
1st Quarter	$8.938	$4.125
2nd Quarter	8.250	5.188
3rd Quarter	7.250	4.050
4th Quarter	5.040	2.040
Fiscal 2000		
1st Quarter	$10.000	$6.578
2nd Quarter	11.188	8.125
3rd Quarter	9.875	7.000
4th Quarter	10.063	8.250

The sources of these quotations for the Company's common stock were Nasdaq's Summary of Activity™ reports and the Nasdaq Online℠ Internet site.

The Company had approximately 1,850 beneficial owners of its common stock, of which 191 are of record, as of December 18, 2001.

The Company has not historically paid dividends on its common or preferred stock. The Board of Directors does not anticipate payment of any dividends in the foreseeable future and intends to continue its present policy of retaining earnings for reinvestment in the operations of the Company. The current credit facility with the Company's principal domestic bank restricts the payment of dividends on its common stock, other than dividends payable in its stock, or the retirement of any of the Company's outstanding shares or the alteration or amendment of the Company's capital structure without the prior written consent of the bank. The Company anticipates the proposed credit facility with the Company's principal bank will also contain similar restrictions.

Series B Convertible Preferred Stock

Shares of the Company's Series B convertible preferred stock were issued in the merger with AMVC on July 12, 2000. These shares are quoted on the Nasdaq SmallCap Market under the symbol "KTECP". The following table shows the high and low bid prices per share of the Company's Series B convertible preferred stock by quarter for the two most recent fiscal years ended September 30:

	High	Low
Fiscal 2001		
1st Quarter	$7.266	$6.438
2nd Quarter	7.625	6.875
3rd Quarter	7.500	6.270
4th Quarter	7.100	4.700
Fiscal 2000		
1st Quarter	N/A	N/A
2nd Quarter	N/A	N/A
3rd Quarter	N/A	N/A
4th Quarter	$7.375	$6.125

The sources of these quotations for the Company's Series B convertible preferred stock were Nasdaq's Summary of Activity™ reports and the Nasdaq Online℠ Internet site.

The Company had approximately 1,387 beneficial owners of its Series B convertible preferred stock, of which 77 are of record, as of December 18, 2001.

Each whole share of Key Technology Series B convertible preferred stock is:

- convertible at the election of the holder at any time for 2/3 of a share of Key Technology common stock; or
- redeemable at the election of the holder after July 12, 2002 for $10.00 in cash; or
- to be redeemed by the Company on July 12, 2005, or may be redeemed earlier by the Company if the average closing price of Key Technology common stock exceeds $15.00 per share for 30 consecutive trading days, for $10.00 in cash plus declared and unpaid dividends, if any.

Upon closing the AMVC acquisition on July 12, 2000, FMC Technologies, Inc. (FMC) option to purchase shares of AMVC common stock was converted into an option to purchase 210,000 shares of Key Technology Series B convertible preferred stock and warrants to purchase 52,500 shares of Key Technology common stock for $2,520,000. This option expires October 14, 2003.

The Series B convertible preferred stock is not entitled to dividends. If a dividend is declared payable on the outstanding common stock, the holders of Series B convertible preferred stock are entitled to the dividend that would be payable on the common stock into which the Series B could convert.

Warrants

Warrants were issued in the merger with AMVC on July 12, 2000. These warrants are quoted on the Nasdaq SmallCap Market under the symbol "KTECW". The following table shows the high and low bid prices of the Company's warrants by quarter for the two most recent fiscal years ended September 30:

	High	Low
Fiscal 2001		
1st Quarter	$9.875	$9.750
2nd Quarter	10.000	9.875
3rd Quarter	9.890	9.813
4th Quarter	9.860	9.800
Fiscal 2000		
1st Quarter	N/A	N/A
2nd Quarter	N/A	N/A
3rd Quarter	N/A	N/A
4th Quarter	$9.875	$9.875

The warrants do not accrue any dividends or interest until exercised and then only to the extent it is exercised.

ITEM 6. SELECTED FINANCIAL DATA.

The selected consolidated financial information set forth below for each of the five years in the period ended September 30, 2001 has been derived from the audited consolidated financial statements of the Company. The information below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Company's Consolidated Financial Statements and Notes thereto as provided in Item 7 and Item 8 of this Annual Report on Form 10-K, respectively.

	Fiscal Year Ended September 30,				
	2001	2000	1999	1998	1997
	(in thousands, except per share data)				
Statement of Earnings (Loss) Data:					
Net sales	$72,954	$67,412	$69,531	$54,132	$58,843
Cost of sales	47,186	42,412	43,838	34,884	41,025
Gross profit	25,768	25,000	25,693	19,248	17,818
Operating expenses	28,190	25,302	21,022	18,085	17,648
Income (loss) from operations	(2,422)	(302)	4,671	1,163	170
Other income (expense)	(1,264)	180	490	226	449
Earnings (loss) from continuing operations before income taxes	(3,686)	(122)	5,161	1,389	619
Income tax (benefit) expense	(1,343)	(168)	1,632	464	197
Net earnings (loss) from continuing operations	$(2,343)	$ 46	$ 3,529	$ 925	$ 422
Total loss on discontinued operation (net of tax)	(2,581)	(379)	--	--	--
Net earnings (loss)	(4,924)	(333)	3,529	925	422
Accretion of manditorily redeemable preferred stock	(939)	(235)	--	--	--
Net earnings (loss) available to common shareholders	$ (5,863)	$ (568)	$ 3,529	$ 925	$ 422
Net earnings (loss) from continuing operations per share – basic and diluted	$ (0.69)	$ (0.04)	$ 0.75	$ 0.20	$ 0.09
Net loss from discontinued operation per share – basic and diluted	$ (0.55)	$ (0.08)	$ --	$ --	$ --
Earnings (loss) per share – basic and diluted	$ (1.24)	$ (0.12)	$ 0.75	$ 0.20	$ 0.09
Cash dividends per share	$ --	$ --	$ --	$ --	$ --
Shares used in per share calculation - basic	4,740	4,723	4,707	4,692	4,674
Shares used in per share calculation – diluted	4,740	4,723	4,711	4,721	4,760

	September 30,				
	2001	2000	1999	1998	1997
			(in thousands)		
Balance Sheet Data:					
Cash and cash equivalents and short-term Investments	$ 738	$ 6,535	$ 6,403	$ 6,333	$ 2,896
Working capital	10,722	25,202	22,973	18,949	17,308
Property, plant and equipment, net.	11,436	13,784	8,582	9,584	9,380
Total assets	74,841	85,417	44,420	39,357	39,441
Current portion of long-term debt	11,739	3,447	304	579	852
Long-term debt, less current portion	6,581	19,483	722	1,103	1,293
Mandatorily redeemable preferred stock and warrants	13,531	17,105	0	0	0
Shareholders' equity	25,711	31,465	32,657	29,315	28,031

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

Introduction

The Company and its wholly-owned subsidiaries design, manufacture and sell process automation systems, integrating electro-optical inspection and sorting and process systems.

The Company consists of Key Technology, Inc. which directly owns three subsidiaries: Key Technology FSC, Inc., a foreign sales corporation (FSC); Key Holdings USA LLC; and Key Technology AMVC LLC. Key Holdings USA LLC owns Suplusco Holdings B.V., its European subsidiary, which owns Key Technology B.V. Key Technology AMVC LLC owns Applied Laser System, Inc. (inactive) and ARC Netherlands B.V. (inactive). The Company manufactures products in Walla Walla, Washington; Redmond, Oregon; and Beusichem, The Netherlands. Through the maintenance of its wholly-owned foreign sales corporation subsidiary, Key Technology FSC, Inc., a portion of the Company's domestically originated foreign trade income is exempt from tax at the corporate level.

The Company acquired Farmco and AMVC on June 1, 2000 and July 12, 2000, respectively. The operations of the acquired entities are included in the consolidated financial statements from their respective acquisition dates and account for a large portion of the fluctuation in amounts between fiscal years 2001, 2000 and 1999.

Results of Operations

For the fiscal years ended September 30, 2001, 2000 and 1999, the Company's net sales were $73.0 million, $67.4 million, and $69.5 million, respectively. Sales of automated inspection systems, process systems, and parts and service/contracts increased by 12%, 2% and 12%, respectively, in fiscal 2001 compared to fiscal 2000. The Company has experienced the benefits of the acquisitions of Farmco and AMVC made in the third and fourth quarters of fiscal 2000, as the incremental net sales from acquisitions accounted for the revenue growth in all product categories in fiscal 2001. Acquired product lines contributed 22% of the systems sold in fiscal 2001. The acquisition of AMVC also helped accelerate the Company's strategy of diversification, as net sales of non-food systems, principally to the tobacco industry, represented 14% of system sales in fiscal 2001. A 46% increase in sales of process systems into the European market were largely offset by decreases in that product group in other parts of the world. Parts and service/contract net sales increased by 12% in fiscal 2001 over fiscal 2000 as a result of the acquisitions of Farmco and AMVC made in fiscal 2000.

The incremental net sales from acquired product lines were partially offset by decreased net sales from the Company's traditional business, the food processing industry in the United States. Sales to the food processing industry continued to weaken in fiscal year 2001 and were unfavorably affected by market factors including:

- Further consolidation among food processors, which resulted in delayed investments in capital equipment by the Company's customers.
- Softness in the vegetable industry caused by processed inventories carried over from the previous season and lower prices for customers' products.
- Higher energy costs in certain sectors of the Company's markets which contributed to reduced spending by customers for both new equipment and maintenance expenditures for parts and service.
- The strength of the U.S. dollar in world markets, which has made U.S.-manufactured goods relatively more expensive to international customers.

The Company did not experience any "turn-key" sales in fiscal 2001 as compared to fiscal 2000 where turn-key sales were approximately $1.8 million.

Net sales in fiscal 2000 decreased by 3% compared to fiscal 1999. Automated inspection systems and parts and service/contracts increased by 7% and 28%, respectively, but these increases were more than offset by decreases in process systems in fiscal 2000 compared to fiscal 1999. Sales for the year ended September 30, 2000 were unfavorably affected by market factors including:

- Consolidation among food processors, which resulted in delayed investments in capital equipment by Key's customers.
- Softness in the vegetable industry caused by processed inventories carried over from the previous season and lower prices for customers' products.
- Customers' higher costs of capital due to increased interest rates in the United States, which delayed certain projects.
- The strength of the U.S. dollar in world markets, which has made U.S.-manufactured goods relatively more expensive to international customers.

Sales by subsidiaries acquired during the third and fourth quarters of fiscal 2000 contributed approximately $5.1 million to the Company's consolidated net sales in fiscal 2000.

Export and international sales accounted for 49%, 41% and 46% of total net sales in fiscal 2001, 2000 and 1999, respectively. An increase in sales to international customers of 29% was partially offset by a 6% decrease in sales to domestic customers in fiscal 2001. European customers represented the largest market for such international sales in each of the three fiscal years.

Gross profit was 35%, 37% and 37% of sales in fiscal 2001, 2000 and 1999, respectively. The gross margin, as a percentage of net sales in fiscal 2001 as compared to fiscal 2000, suffered from decreased margins in automated inspection systems and in parts and service/contracts, partially offset by increased margins in process systems. Automated inspection systems gross margins, as a percent of net sales, decreased by four percentage points in fiscal 2001 from fiscal 2000, principally as the result of a 62% increase in warranty costs, the underutilization of manufacturing facilities and the accounting treatment of acquired inventories. Parts and service/contracts gross margins, as a percent of net sales, decreased by eight percentage points in fiscal 2001 from fiscal 2000, principally as the result of underutilization of field service personnel due to customer cutbacks in maintenance spending, and the costs associated with cross-training of service personnel on all product lines. The gross margins for process systems improved principally as a result of better cost control, and because the Company did not experience any lower margin turn-key sales in fiscal 2001 as compared to $1.8 million of turn-key sales in fiscal 2000.

The gross margin, as a percentage of net sales in fiscal 2000 compared to fiscal 1999, benefited from improved margins in automated inspection systems and in parts and service, offset by decreased gross margins in process systems. Automated inspection system gross margins, as a percent of sales, improved two percentage points in fiscal 2000 over fiscal 1999, principally the result of a 16% decrease in warranty costs, which continued the favorable trend of a 41% decrease in warranty costs in the previous year. The gross margins for parts and service/contracts improved principally as a result of an increased volume of higher margin upgrades. Decreased process systems gross margins were principally due to an increase in manufacturing overhead resulting from decreased production volumes between the two comparable periods. Process system revenues in both fiscal 2000 and 1999 included a variety of third-party supplied equipment and installation services which were sold at very low margins as components of larger processing lines. During fiscal 2000, third-party supplied products accounted for approximately $1.8 million of $26.4 million in total net sales of process systems compared to $3.1 million of the $34.0 million in total net sales in fiscal 1999.

Operating expenses increased to $28.2 million in fiscal 2001 from $25.3 million in fiscal 2000 and $21.0 million in fiscal 1999, and represented 39%, 38% and 30% of net sales in each such year, respectively. Operating expenses in fiscal 2001 include a full year of operating expenses and amortization of intangibles of acquired companies, while fiscal 2000 included such expenses for only approximately one quarter. Substantial expense reductions from the higher expense levels earlier in the year have resulted in a lower run rate and, therefore the Company expects that total operating expenses in fiscal 2002 should approximate 29 to 31 percent of fiscal 2002 revenues.

Selling and marketing expenses were $13.2 million in fiscal 2001, $12.8 million in fiscal 2000 and $11.1 million in fiscal 1999, and represented 18%, 19% and 16% of net sales in each such year, respectively. In fiscal 2001, selling and marketing expenses increased 4% over fiscal 2000, principally due to the expenses contributed by the acquisitions. Selling and marketing expenses in fiscal 2000 increased 15% compared to fiscal 1999, also principally due to the expenses contributed by acquisitions. The Company also increased investment in new product promotions related to four new products introduced in fiscal 2000 and expanded sales coverage to new European and Latin American markets.

Research and development expenses increased in fiscal 2001 to $5.4 million from $5.3 million in fiscal 2000 and $4.3 million in fiscal 1999, and represented 7%, 8% and 6% of net sales in each such year, respectively. Research and development expenses in fiscal 2001 increased by approximately 2%

compared to fiscal 2000, and research and development expenses in fiscal 2000 increased by approximately 23% compared to 1999. The increases in both periods are principally due to expenses contributed by acquisitions. Activities in fiscal 2002 will focus on continuing to extend the capabilities and applications of the technologies contained in Optyx, Tegra and Prism, and development of new inspection technologies.

General and administrative expenses increased to $7.5 million in fiscal 2001 from $5.7 million in fiscal 2000 and $5.4 million in fiscal 1999, and represented 10%, 9% and 8% of net sales in each such year, respectively. General and administrative expenses increased in fiscal 2001 by approximately 31% compared to fiscal 2000 as a result of a full year of combined operations in fiscal 2001 as compared to only a partial year in fiscal 2000. General and administrative expense in fiscal 2000 increased approximately 7% compared to fiscal 1999 also as a result of the acquisitions of Farmco and AMVC made in the third and fourth quarters of fiscal 2000.

The increase in amortization of intangibles is the result of a full year of amortization of acquired intangibles as compared to only a partial year in fiscal 2000. The Company obtained independent appraisals of the fair market value of the AMVC intangible assets acquired. Acquired intangible assets, including goodwill, patents, existing technologies and established customer base, are amortized over the shorter of their remaining lives or periods of 10 to 15 years. A one-time charge of $800,000 associated with the write-off of acquired in-process research and development was recorded immediately subsequent to the acquisition of AMVC in the Company's fourth quarter of fiscal 2000.

Other income and expense includes interest income and expense, royalty income and other income from miscellaneous sources. Net interest expense in fiscal 2001 was $1.5 million compared to net interest expense of $48,000 in fiscal 2000 and net interest income of $210,000 in fiscal 1999. The increase in net interest expense in fiscal 2001 compared to fiscal 2000 resulted from increased interest expense on long-term debt arising from the acquisitions in the third and fourth quarter of fiscal 2000 and lower interest earnings as a result of lower invested cash and cash equivalents, and short-term investment balances. During fiscal 2001, the Company received royalty payments of $131,000 compared to total royalty income of $110,000 in fiscal 2000 and $77,000 in fiscal 1999. As part of a settlement agreement entered into during 1997, the Company received royalty payments through fiscal 2001 related to the sale of certain equipment to a selected market. The Company recognized royalty income from this agreement of $122,000 in fiscal 2001, $71,000 in fiscal 2000 and $26,000 in fiscal 1999. During fiscal 2001, the Company recognized foreign currency transaction gains totaling $242,000 on cash and accounts receivable held primarily in Euros and Dutch guilders. This compares to foreign currency transaction losses of $407,000 in fiscal 2000 and foreign currency transaction gains of $58,000 in fiscal 1999.

The Company's effective income tax rate was a tax benefit of 36.5% and 137.2% in fiscal 2001 and fiscal 2000, respectively, and tax expense of 31.6% for fiscal 1999. The effective tax benefit or tax expense rate varies from the statutory rate of 34% due to permanent differences in tax obligations arising from activities of the FSC, research and development tax credits, and other permanent differences. The larger variance from statutory rates in fiscal 2000 compared to fiscal 2001 and 1999 is principally due to the small taxable net loss reported for fiscal 2000 compared to larger taxable earnings or loss for the other fiscal years.

Prior to September 30, 2001, the Company committed to a plan to sell Ventek, Inc., a wholly-owned subsidiary that supplies machine vision systems to the forest products industry. Ventek was acquired as part of the acquisition of AMVC. The Company's strategic objective when it purchased AMVC was to acquire SRC Vision (SRC), which the Company believes yielded the expected synergies. The Company did not experience the same synergies with Ventek, which served different markets. Ventek was also adversely affected by the slowdown in the forest products industry over the past year, resulting in a decreased financial contribution to the consolidated group. The sale of Ventek continues the efforts the Company has taken throughout the year to reduce costs and improve its financial results. As a result of the sale of Ventek, the Company recorded a loss on the sale of discontinue operations of approximately \$2.1 million in fiscal 2001. See Note 2 to the Company's Consolidated Financial Statements for a more complete description of the sale of Ventek.

Net loss after tax was \$4.9 million in fiscal 2001 compared to a net loss of \$333,000 in fiscal 2000 and net earnings of \$3.5 million in fiscal 1999. Basic and diluted net loss per share in fiscal 2001 was \$1.24 compared to net loss per share of \$0.12 in fiscal 2000 and earnings per share of \$0.75 in fiscal year 1999. The net loss of \$4.9 million for the year ended September 30, 2001 included merger-related and one-time acquisition costs of \$3.4 million, or \$2.1 million after tax, and the loss on the sale of Ventek of \$2.1 million. Excluding these merger-related and non-recurring integration costs, as well as the loss on the sale of Ventek, the net loss would have been \$643,000, or \$0.33 per diluted share for the year ended September 30, 2001. The increase in the net loss in fiscal 2001 compared to fiscal 2000 resulted principally from decreased gross margins due to an increase in warranty costs, integration and overhead costs associated with the combination of the service and manufacturing organizations resulting from the AMVC acquisition and the required accounting treatment of acquisition-related inventories. The decrease in net earnings in fiscal 2000 compared to fiscal 1999 was principally due to decreased sales volume in the Company's core business and the one-time acquisition costs and amortization related to acquisitions.

Liquidity and Capital Resources

During fiscal 2001, net cash provided by operating activities totaled \$2.8 million compared to \$4.2 million and \$1.9 million in fiscal 2000 and 1999, respectively. During fiscal 2001, cash provided by operating activities was affected by an increase in accounts receivable totaling \$4.2 million that resulted from slower payment patterns of certain European customers and the grant of extended payment terms to certain customers. The Company believes that these receivables are fully collectible or sufficiently reserved for. During fiscal 2000 cash was generated by a decrease in accounts receivable totaling \$4.2 million that resulted principally from a decrease in sales volume and improved accounts receivable management. Accounts receivable balances during fiscal 1999 increased, and cash decreased, by \$3.8 million. Operating activities during 2001 provided \$5.1 million in cash from a decrease in inventory compared to \$1.3 million provided by a decrease in inventories in fiscal 2000 and \$2.1 million used by an increase in inventories in 1999. Increases in trade accounts payable, income taxes payable and a decrease in prepaid expenses, partially offset by decreases in accrued payroll liabilities, accrued customer support and warranty costs, other accrued liabilities and customer deposits provided cash of \$1.3 million during fiscal 2001. By comparison, decreases in trade accounts payable, accrued payroll liabilities, income taxes payable, other accrued liabilities, and increases in prepaid expenses, utilized cash totaling \$6.3 million during fiscal 2000. The Company was provided cash totaling \$2.0 million in fiscal 1999 by increases in trade accounts payable, accrued payroll liabilities and income taxes payable, partially offset by a decrease in accrued customer support and warranty costs and an increase in prepaid expenses.

Net cash resources from investing activities totaling $621,000, $2.2 million and $1.3 million were used to fund the acquisition of capital equipment during 2001, 2000 and 1999, respectively. At September 30, 2001, the Company had no material commitments for capital expenditures. The Company generated $478,000 from the sale of excess properties in fiscal 2001. In fiscal 2000 the Company used $16.2 million of cash to acquire AMVC and Farmco during the third and fourth quarters. There were no purchases or sales of short-tem investments in fiscal 2001. Net proceeds of $1.0 million arising from the sale and purchase of short-term investments in fiscal 2000 compared to net investments of $984,000 used to purchase short-term investments in fiscal 1999.

The Company's cash flows from financing activities were affected in fiscal 2001 by cash generated from short-term borrowings of $2.0 million. There were no short-term borrowings in fiscal 2000 and 1999. The Company repaid long-term debt during fiscal 2001, 2000 and 1999 totaling $5.6 million, $2.8 million and $539,000, respectively. Separately, cash flows from the issuance of long-term debt totaled $18.2 million for fiscal 2000 with no such issuances in fiscal 2001 and 1999. Proceeds from the issuance of common stock under the Company's employee stock option and stock purchase plans during fiscal 2001, 2000 and 1999 totaled $71,000, $146,000 and $77,000, respectively. During fiscal 2001 and 2000, the Company redeemed for cash warrants totaling $2.1 million and $703,000, respectively. During fiscal 2001, the Company redeemed for cash its series C preferred stock totaling $2.4 million. There were no redemptions of warrants in fiscal 1999 and no redemptions of series C preferred stock in fiscal 2000 and 1999.

The Company had a domestic credit accommodation with a commercial bank which provided for revolving credit loans and an operating line up to $4,500,000. The operating line expired November 30, 2001 and was repaid. Borrowings under the operating line were $2,000,000 and zero at September 30, 2001 and 2000, respectively. In January 2002, the Company completed the refinancing of its domestic credit accommodation. The refinanced domestic credit accommodation provides for a term loan of $6,500,000 and a revolving credit facility of up to the lesser of $10,000,000 or the available borrowing base, which is based on varying percentages of eligible accounts receivable and inventories. The refinanced domestic credit accommodation bears interest at the bank's prime rate plus 2% per annum, is secured by all of the personal property of the Company and its subsidiaries and contains covenants which require the maintenance of a debt service ratio, as defined, and limits capital expenditures. The $6,500,000 term loan requires quarterly principal installments of $500,000 beginning March 31, 2002 plus 50% of excess cash flow (as defined in the borrowing agreement), subject to certain minimum payments through October 2003. The $10,000,000 credit facility expires in November 2002. At that time the Company will need to renew or refinance this facility. At present, the Company's best estimate anticipates generating sufficient cash flow from operations to meet all known principal and interest payments on existing debt through 2002.

With the acquisition of AMVC, the Company assumed a mortgage note with a domestic commercial bank on its Medford facility which had a balance of $2.9 million at September 30, 2001. The Company and the bank have determined that the Company is in compliance with all provisions of this loan. The Company is currently trying to sell this facility.

The Company's operating, investing and financing activities during fiscal 2001 resulted in a decrease of cash and cash equivalents totaling $5.4 million, compared to an increase totaling $950,000 in 2000 and a decrease totaling $914,000 in 1999. The balance of cash and cash equivalents totaled $738,000, $6.4 million and $5.4 million at the end of fiscal 2001, 2000 and 1999, respectively.

On November 30, 2001 the Company completed the sale of Ventek, Inc. to Veneer Technology, Inc. The Company received a cash payment of approximately \$3.6 million, a deferred payment obligation of approximately \$900,000 and the tender for cancellation of Veneer Technology's holdings of Key Technology Series B convertible preferred stock having a stated redemption value of \$2.0 million. The cash proceeds from the sale were used to pay down Company debt and increase cash reserves.

In connection with the acquisition of AMVC, the Company issued Series B Convertible Preferred stock, Series C Convertible Preferred stock and warrants, each of which carries conversion or redemption privileges. A complete description of these instruments is contained in the Company's Registration Statement on Form S-4, Post-Effective Amendment No. 1, filed March 23, 2001. Series C Convertible Preferred stock was redeemed during fiscal 2001 for a total of \$2.4 million. A brief description of the securities outstanding at November 30, 2001 is as follows:

- Outstanding Series B Convertible Preferred stock at November 30, 2001, after the tender for cancellation of Veneer Technology's holdings of Series B Convertible Preferred stock, totaled 1,137,404 shares. Each share is convertible at any time at the election of the holder for 2/3 share of the Company's Common stock, or redeemable at the election of the holder beginning July 12, 2002 for \$10 per share.
- Outstanding warrants at November 30, 2001 totaled 80,550. Each five-year warrant entitles the holder to purchase one share of the Company's Common stock for \$15 or is redeemable at \$10 per warrant at any time at the election of the holder.

If all holders were to redeem their preferred stock and warrants at the earliest possible time, the cash requirements would be \$805,000 presently and an additional \$11.4 million in July 2002. The Company's ability to make cash payments with respect to such equity redemption obligations and to satisfy or refinance its other debt obligations will in part depend upon its future operating performance. The Company believes, based on current circumstances, that its cash flow from operations, together with anticipated available borrowings under its new revolving credit facility, will not be sufficient to permit it to pay in full its potential equity redemption obligations in July 2002. As a result, the Company will be required to pursue alternatives that may include reducing or delaying capital expenditures, selling assets, restructuring or refinancing present debt, restructuring the terms of the preferred stock, or seeking additional subordinated debt or equity capital. While the Company anticipates operating results sufficient to support the availability of these or other alternatives, there can be no assurance that any of these alternatives can be effected on satisfactory terms, if at all. There is no assurance that the Company will be able to obtain additional or alternative financing or that such financing, if available, will be on terms favorable to the Company.

The Euro Conversion

On January 1, 1999, certain member countries of the European Union, including the Netherlands, established fixed conversion rates between their existing sovereign (legacy) currencies and the Euro, leading to the adoption of the Euro by these countries as their common legal currency. The information systems of the Company's European subsidiary, Key Technology B.V., currently accommodates multiple currency transactions and has integrated Euro denominated transactions with no difficulty. Key Technology began implementing a conversion of its business systems to the Euro concurrent with the start of the Company's fiscal 2000 year. The Company completed the conversion in October 2001, well before January 1, 2002 when the legacy currencies may no longer be legal tender.

Future Accounting Changes

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, *Business Combinations*. The statement discontinues the use of the pooling of interest method of accounting for business combinations. The statement is effective for all business combinations after June 30, 2001. Management has completed an evaluation of the effects of this statement and believes that it will not have a material effect on the Company's consolidated financial statements.

In July 2001, the FASB issued SFAS No. 142, *Goodwill and Other Intangible Assets*, which is effective October 1, 2002 and may be early adopted by the Company prior to its filing of its first quarter financial statements on Form 10-Q for the quarter ending December 31, 2001. SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill, and the identification of reporting units for purposes of assessing potential future impairments of goodwill. SFAS No. 142 also requires the Company to complete a transitional goodwill impairment test within six months from the date of adoption. The Company is currently assessing but has not yet determined the effect of SFAS No. 142 on its financial position and results of operations. Goodwill amortization was $749,000, $299,000, and $155,000 during the years ended September 30, 2001, 2000, and 1999, respectively.

In August 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, which is effective October 1, 2003. SFAS No. 143 requires, among other things, the accounting and reporting of legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, or normal operation of a long-lived asset. The Company is currently assessing but has not yet determined the effect of SFAS No. 143 on its financial position, results of operations, and cash flows.

In October 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which is effective October 1, 2002 but may be early adopted. SFAS No. 144 addresses accounting and reporting of all long-lived assets, except goodwill, that are either held and used or disposed of through sale or other means. The Company has early adopted the provisions of SFAS No. 144 related to discontinued operations (see Note 2).

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

The Company has assessed its exposure to market risks for its financial instruments and has determined that its exposures to such risks are generally limited to those affected by the strength of the U.S. Dollar against the Euro and the Dutch guilder.

The terms of sales to European customers by Key Technology B.V., the Company's European subsidiary, are typically denominated in either Euros, U.S. Dollars, Dutch guilders or to a far lesser extent, the respective legacy currencies of its European customers. The Company expects that its standard terms of sales to international customers, other than those in Europe, will continue to be denominated in U.S. dollars. For sales transactions between international customers, including

European customers, and the Company's domestic operations which are denominated in currencies other than U.S. dollars, the Company assesses its currency exchange risk and may enter into a currency hedging transaction to minimize such risk. At September 30, 2001, the Company was not a party to any currency hedging transaction. As of September 30, 2001, management estimates that a 10% change in foreign exchange rates would affect net income before taxes by approximately $110,000 on an annual basis as a result of converted cash and accounts receivable denominated in foreign currencies.

During the Company's fiscal 2001, the Euro and the Dutch guilder lost 3% of their respective values against the U.S. dollar. The majority of this currency exchange movement occurred in the last two months of the Company's fiscal year. The effect of the stronger dollar on the operations and financial results of the Company were:

- Translation adjustments of $31,000, net of income tax, were recognized as a component of comprehensive income in the Company's Statement of Shareholders' Equity as a result of converting the guilder denominated balance sheet of Key Technology B.V. into U.S. dollars.
- Foreign exchange gains of $242,000 were recognized in the other income and expense section of the consolidated income statement as a result of conversion of guilder and Euro denominated receivables and cash carried on the balance sheet of the U.S. operations as well as the result of the conversion of other non-functional currency receivables and cash carried on the balance sheet of the European operations.

A relatively strong U.S. dollar on the world markets makes the Company's U.S.-manufactured goods relatively more expensive to international customers when denominated in U.S. dollars or potentially less profitable to the Company when denominated in a foreign currency. Although the Company experienced strong orders from and shipments to international markets during fiscal 2001, the continuing strength of the U.S. dollar on the world markets may unfavorably affect the Company's market and economic outlook for these international sales.

The Company anticipates that the reduction of U.S. interest rates both during and subsequent to the close of the year ended September 30, 2001 will result in a corresponding reduction of customers' cost of capital, which had previously delayed certain projects. However, there can be no assurance that customers in the Company's markets will maintain or increase their investment in Company products as a result of changes in the cost of capital and other market or economic factors.

Subsequent to the end of the period, in January 2002, the Company entered into a new credit accommodation with a domestic bank. Under this new facility the Company may borrow at the lender's prime rate plus 200 basis points. At September 30, 2001, the Company had $16.2 million of borrowings which had variable interest rates. During the year then ended, interest on the credit facility varied from 3.30% to 9.75%. Currently the rate is 6.75%. As of September 30, 2001 management estimates that a 100 basis point change in the interest rate would affect net income before taxes by approximately $162,000 on an annual basis.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

INDEPENDENT AUDITORS' REPORT

Key Technology, Inc.
Walla Walla, Washington

We have audited the accompanying consolidated balance sheets of Key Technology, Inc. and subsidiaries as of September 30, 2001 and 2000, and the related consolidated statements of earnings (loss), shareholders' equity, and cash flows for each of the three years in the period ended September 30, 2001. The consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Key Technology, Inc. and Subsidiaries as of September 30, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2001 in conformity with accounting principles generally accepted in the United States of America.

DELOITTE & TOUCHE LLP

Portland, Oregon
January 10, 2002

KEY TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2001 AND 2000
(In Thousands)

ASSETS	2001	2000
CURRENT ASSETS:		
Cash and cash equivalents	$ 738	$ 6,427
Short-term investments	-	108
Trade accounts receivable, net	13,072	9,426
Inventories	14,461	22,011
Deferred income taxes	1,884	1,699
Prepaid expenses and other assets	824	2,372
Assets held for sale	8,460	-
Total current assets	39,439	42,043
PROPERTY, PLANT, AND EQUIPMENT, Net	11,436	13,784
DEFERRED INCOME TAXES	5,376	1,237
OTHER ASSETS	108	445
GOODWILL AND OTHER INTANGIBLES, Net	18,482	27,908
TOTAL	$ 74,841	$ 85,417

See notes to consolidated financial statements.

(Continued)

KEY TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2001 AND 2000
(In Thousands, Except Shares)

LIABILITIES AND SHAREHOLDERS' EQUITY	2001	2000
CURRENT LIABILITIES:		
Short-term borrowings	$ 2,000	$ -
Accounts payable	5,395	3,843
Accrued payroll liabilities and commissions	2,533	3,972
Accrued customer support and warranty costs	1,015	947
Income tax payable	338	185
Other accrued liabilities	1,061	1,790
Customers' deposits	2,200	2,657
Current portion of long-term debt	11,739	3,447
Liabilities held for sale	2,436	-
Total current liabilities	28,717	16,841
LONG-TERM DEBT	6,581	19,483
DEFERRED INCOME TAXES	301	523
COMMITMENTS AND CONTINGENCIES	-	-
MANDATORILY REDEEMABLE PREFERRED STOCK	12,705	14,156
WARRANTS	826	2,949
SHAREHOLDERS' EQUITY:		
Preferred stock - no par value; 5,000,000 shares authorized; none issued and outstanding	-	-
Common stock - no par value; 15,000,000 shares authorized; 4,751,346 and 4,733,560 issued and outstanding 2001 and 2000, respectively	9,407	9,329
Retained earnings	17,507	23,370
Accumulated comprehensive loss	(1,203)	(1,234)
Total shareholders' equity	25,711	31,465
TOTAL	$ 74,841	$ 85,417

See notes to consolidated financial statements. (Concluded)

KEY TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)
THREE YEARS ENDED SEPTEMBER 30, 2001
(In Thousands, Except Per Share Data)

	2001	2000	1999
NET SALES	$ 72,954	$ 67,412	$ 69,531
COST OF SALES	47,186	42,412	43,838
Gross profit	25,768	25,000	25,693
OPERATING EXPENSES:			
Selling	13,248	12,777	11,125
Research and development	5,371	5,278	4,282
General and administrative	7,487	5,734	5,378
Amortization of intangibles	2,084	713	237
In-process research and development	-	800	-
Total operating expenses	28,190	25,302	21,022
INCOME (LOSS) FROM OPERATIONS	(2,422)	(302)	4,671
OTHER INCOME (EXPENSE):			
Royalty income	131	110	77
Interest income	126	379	318
Interest expense	(1,673)	(427)	(108)
Other, net	152	118	203
Total other income (expense) - net	(1,264)	180	490
Earnings (loss) from continuing operations before income taxes	(3,686)	(122)	5,161
Income tax (benefit) expense	(1,343)	(168)	1,632
Net earnings (loss) from continuing operation	(2,343)	46	3,529
Loss from discontinued operation (net of income tax)	(436)	(379)	-
Loss on sale of discontinued operation (net of income tax)	(2,145)	-	-
Total loss from discontinued operation	(2,581)	(379)	-
NET EARNINGS (LOSS)	(4,924)	(333)	3,529
Accretion of mandatorily redeemable preferred stock	(939)	(235)	-
Net earnings (loss) available to common shareholders	$ (5,863)	$ (568)	$ 3,529

See notes to consolidated financial statements.

(Continued)

KEY TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)
THREE YEARS ENDED SEPTEMBER 30, 2001
(In Thousands, Except Per Share Data)

	2001	2000	1999
Net earnings (loss) from continuing operations per share - basic and diluted	$ (0.69)	$ (0.04)	$ 0.75
Net loss from discontinued operations per share - basic and diluted	$ (0.55)	$ (0.08)	$ -
EARNINGS (LOSS) PER SHARE - Basic and diluted	$ (1.24)	$ (0.12)	$ 0.75
SHARES USED IN PER SHARE CALCULATION - Basic	4,740	4,723	4,707
SHARES USED IN PER SHARE CALCULATION - Diluted	4,740	4,723	4,711

See notes to consolidated financial statements. (Concluded)

KEY TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
THREE YEARS ENDED SEPTEMBER 30, 2001
(Dollars In Thousands)

	Common Stock			Accumulated	
	Shares	Amount	Retained Earnings	Comprehensive Income (Loss)	Total
Balance at October 1, 1998	4,701,502	$ 9,106	$ 20,409	$ (200)	$ 29,315
Components of comprehensive income (loss):					
Net earnings			3,529		3,529
Comprehensive loss - foreign currency translation adjustment, net of tax				(264)	(264)
Total comprehensive income					3,265
Issuance of common stock upon exercise of stock options	100	1	-	-	1
Issuance of stock for Employee Stock Purchase Plan	12,393	76	-	-	76
Balance at September 30, 1999	4,713,995	9,183	23,938	(464)	32,657
Components of comprehensive income (loss):					
Net loss			(333)		(333)
Comprehensive loss - foreign currency translation adjustment, net of tax				(770)	(770)
Total comprehensive loss					(1,103)
Accretion of mandatorily redeemable preferred stock			(235)		(235)
Issuance of common stock upon exercise of stock options	11,500	85	-	-	85
Issuance of stock for Employee Stock Purchase Plan	8,065	61	-	-	61
Balance at September 30, 2000	4,733,560	9,329	23,370	(1,234)	31,465
Components of comprehensive income (loss):					
Net loss			(4,924)		(4,924)
Comprehensive income - foreign currency translation adjustment, net of tax				31	31
Total comprehensive loss					(4,893)
Accretion of mandatorily redeemable preferred stock			(939)	-	(939)
Issuance of common stock upon exercise of preferred stock and warrants	602	7	-	-	7
Issuance of stock for Employee Stock Purchase Plan	17,184	71	-	-	71
Balance at September 30, 2001	4,751,346	$ 9,407	$ 17,507	$ (1,203)	$ 25,711

See notes to consolidated financial statements.

KEY TECHNOLOGY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE YEARS ENDED SEPTEMBER 30, 2001
(In Thousands)

	2001	2000	1999
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net earnings (loss)	$ (4,924)	$ (333)	$ 3,529
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:			
Loss from sale of discontinued operations, net of tax	2,145	-	-
Loss from discontinued operations, net of tax	436	379	-
Foreign currency exchange (gain) loss	(242)	407	(58)
Depreciation and amortization	4,530	3,086	2,371
In-process research and development	-	800	-
Deferred income taxes	(1,343)	787	(30)
Deferred rent	26	31	42
Bad debt expense (recoveries)	63	(103)	(117)
Changes in assets and liabilities:			
Trade accounts and notes receivable	(4,204)	4,171	(3,768)
Inventories	5,052	1,334	(2,125)
Prepaid expenses and other current assets	830	(1,181)	(452)
Accounts payable	2,212	(659)	354
Accrued payroll liabilities and commissions	(1,259)	(665)	1,665
Accrued customer support and warranty costs	(104)	(24)	(246)
Income taxes payable	171	(314)	256
Other accrued liabilities	(735)	(3,442)	280
Customers' deposits	(183)	66	189
Other	323	(106)	-
Cash provided by operating activities	2,794	4,234	1,890
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sale of short-term investments	-	3,500	-
Purchases of short-term investments	-	(2,519)	(984)
Proceeds from sale of property	478	-	-
Purchases of property, plant, and equipment	(621)	(2,165)	(1,338)
Cash paid for acquired companies, net of cash acquired	-	(16,208)	-
Cash used in investing activities	(143)	(17,392)	(2,322)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from short-term borrowings	2,000	-	-
Payments on long-term debt	(5,591)	(2,750)	(539)
Proceeds from issuance of long-term debt	-	18,150	-
Redemption of warrants	(2,122)	(703)	-
Redemption of preferred stock	(2,382)	-	-
Proceeds from issuance of common stock	71	146	77
Cash provided by (used in) financing activities	(8,024)	14,843	(462)

See notes to consolidated financial statements.

(Continued)

CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE YEARS ENDED SEPTEMBER 30, 2001
(In Thousands)

	2001	2000	1999
EFFECT OF EXCHANGE RATE CHANGES ON CASH	$ (42)	$ (735)	$ (20)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS FROM CONTINUING OPERATIONS	(5,415)	950	(914)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS FROM DISCONTINUED OPERATIONS	(274)	58	-
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	6,427	5,419	6,333
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 738	$ 6,427	$ 5,419
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the year for interest	$ 1,818	$ 344	$ 148
Cash paid (received) during the year for income taxes	(731)	880	1,408
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Equipment obtained through capital leases	$ 126	$ 96	$ -
Accounts payable paid through lease financing	856	-	-
Noncash portion of acquisitions (assumption of liabilities and issuance of mandatorily redeemable preferred stock and warrants)	-	33,249	-

See notes to consolidated financial statements. (Concluded)

1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Key Technology, Inc. and its wholly-owned subsidiaries (the "Company") design, manufacture, and sell process automation systems, integrating electro-optical inspection and sorting, specialized conveying and product preparation equipment. The consolidated financial statements include the accounts of Key Technology, Inc. and its wholly-owned subsidiaries, Key Technology Holdings U.S.A., LLC, Key Technology AMVC LLC, and Key Technology FSC, Inc., a foreign sales corporation (FSC). Suplusco Holding B.V., a wholly-owned European subsidiary of Key Technology Holdings U.S.A., LLC includes the accounts of Key Technology, B.V. AMVC LLC includes the accounts of ARC Netherlands B.V. (inactive) and Applied Laser Systems, Inc. (inactive). All significant intercompany accounts and transactions have been eliminated.

Revenue Recognition – Sales revenue net of allowances is recognized at the time equipment is shipped to customers or when title passes, or in the case of trial units, upon the customers' acceptance of the product. Revenue from maintenance and support contracts is recognized ratably over the period the service is provided. Revenue from other service contracts is recognized at the time the service is provided. Upon receipt of an order, the Company generally receives a deposit which is recorded as customers' deposits. The Company makes periodic evaluations of the creditworthiness of its customers and generally does not require collateral. An allowance for credit losses is provided based upon historical experience and anticipated losses.

Cash and Cash Equivalents and Short-Term Investments – The Company considers all highly liquid investments with original maturities of 90 days or less at date of acquisition to be cash equivalents. The Company invests from time-to-time in short-term investments which consist primarily of bankers acceptances and commercial paper with original maturities of greater than 90 days and less than one year. These short-term investments are typically held to maturity and the carrying value approximates fair value.

Inventories are stated at the lower of cost (first-in, first-out method) or market.

Property, Plant, and Equipment are recorded at cost and depreciated over estimated useful lives on the straight-line method. The range in lives for assets is as follows:

	Years
Buildings and improvements	7 to 40
Manufacturing equipment	5 to 10
Office equipment, furniture, and fixtures	3 to 7

Goodwill and Other Intangibles – Goodwill is amortized over the estimated useful lives of the related goodwill or 15 years, whichever is shorter. Patent costs are amortized over the estimated useful lives of the related patents or 17 years, whichever is shorter. Management periodically evaluates the recoverability of goodwill and other intangibles based upon current and anticipated net income and undiscounted future cash flows. Amortization of goodwill and other intangibles was $2,084,000, $713,000, and $237,000 for the years ended September 30, 2001, 2000, and 1999, respectively.

Accrued Customer Support and Warranty Costs – The Company provides customer support services consisting of installation and training to its customers. The Company also provides a warranty on its products ranging from ninety days to two years following the date of shipment. Management establishes a reserve for customer support and warranty costs based upon the types of products shipped, customer support and product warranty experience and estimates such costs for related new products where experience is not available. The provision of customer support and warranty costs is charged to cost of sales at the time such costs are known or estimable.

Income Taxes – Deferred income taxes are provided for the effects of temporary differences arising from differences in the reporting of revenues and expenses for financial statement and income tax purposes under the asset and liability method using currently enacted tax rates.

Foreign Currency Translation – Assets and liabilities denominated in a foreign currency are translated to U.S. dollars at the exchange rate on the balance sheet date. Translation adjustments are shown separately in shareholders' equity. Revenues, costs, and expenses are translated using an average rate. Realized and unrealized foreign currency transaction gains and losses are included in the consolidated statement of earnings.

Impairment of Long-Lived Assets – The Company evaluates its long-lived assets for financial impairments and will continue to evaluate them if events or changes in circumstance indicate the carrying amount of such assets may not be fully recoverable.

Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Financial Instruments – The carrying value of the Company's cash and cash equivalents, short-term investments, accounts and notes receivable, trade payables, and other accrued liabilities approximates their estimated fair values due to the short maturities of those instruments.

Earnings Per Share – Basic earnings (loss) per share ("EPS") has been computed by dividing net earnings (loss) available to common shareholders by the weighted average number of shares outstanding during each period. Diluted EPS has been computed by dividing net earnings (loss) available to common shareholders by the weighted average common stock and common stock equivalent shares outstanding during each period using the treasury stock method for employee stock option plans and warrants, and the if-converted method for mandatorily redeemable preferred stock, if the common equivalent shares were not anti-dilutive. In fiscal years 2001 and 2000, all common stock equivalents were anti-dilutive. Net earnings (loss) for the calculation of both basic and diluted EPS is the same for each period presented. The calculation of the weighted average outstanding shares is as follows (in thousands):

	2001	2000	1999
Weighted average shares outstanding - basic	4,740	4,723	4,707
Common stock options and warrants	-	-	4
Weighted average shares outstanding - diluted	4,740	4,723	4,711

Options to purchase 699,433 and 724,833 shares of common stock were outstanding as of September 30, 2001 and 2000, respectively, but were not included in the computation of diluted EPS for the year then ended because the options were anti-dilutive. These options expire on dates beginning May 2003 through February 2011. For the year ended September 30, 1999, options for 509,183 shares of common stock were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the common stock. As of September 30, 2001, common equivalent shares of 892,756 and 82,200 from assumed conversion of mandatorily redeemable preferred stock and warrants, respectively, were not included in the computation of diluted EPS due to anti-dilution. As of September 30, 2000, common equivalent shares of 1,091,543 and 294,551 from assumed conversion of mandatorily redeemable preferred stock and warrants, respectively, were not included in the computation of diluted EPS due to anti-dilution.

Future Accounting Changes – In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, *Business Combinations*. The statement discontinues the use of the pooling of interest method of accounting for business combinations. The statement is effective for all business combinations after June 30, 2001. Management has completed an evaluation of the effects of this statement and believes that it will not have a material effect on the Company's consolidated financial statements.

In July 2001, the FASB issued SFAS No. 142, *Goodwill and Other Intangible Assets*, which is effective October 1, 2002 and may be early adopted by the Company prior to its filing of its first quarter financial statements on Form 10-Q for the quarter ending December 31, 2001. SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill, and the identification of reporting units for purposes of assessing potential future impairments of goodwill. SFAS No. 142 also requires the Company to complete a transitional goodwill impairment test within six months from the date of adoption. The Company is currently assessing but has not yet determined the effect of SFAS No. 142 on its financial position and results of operations. Goodwill amortization was $749,000, $299,000, and $155,000 during the years ended September 30, 2001, 2000, and 1999, respectively.

In August 2001, the FASB issued SFAS No. 143, *Accounting for Asset Retirement Obligations*, which is effective October 1, 2003. SFAS No. 143 requires, among other things, the accounting and reporting of legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, or normal operation of a long-lived asset. The Company is currently assessing but has not yet determined the effect of SFAS No. 143 on its financial position, results of operations, and cash flows.

In October 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which is effective October 1, 2002 but may be early adopted. SFAS No. 144 addresses accounting and reporting of all long-lived assets, except goodwill, that are either held and used or disposed of through sale or other means. The Company has early adopted the provisions of SFAS No. 144 related to discontinued operations (see Note 2).

Other Assets includes approximately $280,000 of a note receivable due from a director of the Company at September 30, 2000. The note was repaid by the director during the year ended September 30, 2001.

Reclassifications – Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

Shipping and Handling – In the fourth quarter of fiscal 2001, the Company adopted Emerging Issues Task Force Issue No. 00-10, *Accounting for Shipping and Handling Fees and Costs* ("EITF 00-10"). As a result, the Company now accounts for revenue generated by shipping products to customers as net sales. Previously, these amounts were included in other income (expense) along with the related costs incurred to ship the products. Net sales, cost of sales, and other income (expense) for prior periods have been restated to reflect EITF 00-10. This change has no effect on reported net earnings (loss) or earnings (loss) per share.

2. DISCONTINUED OPERATION

Prior to September 30, 2001, management, with Board of Directors approval, committed to a plan to sell Ventek, Inc. ("Ventek"), a wholly-owned subsidiary that supplies machine vision systems to the forest products industry. Ventek was acquired by Key as part of its acquisition of Advanced Machine Vision Corporation ("AMVC") in July 2000. In October 2001, the Company signed a definitive agreement to sell Ventek to Veneer Technology, Inc., a company owned by four current managers of Ventek. The terms of the sale include a cash payment of approximately $3.6 million, a note for $0.9 million and the cashless tender of Veneer Technology's holdings of Key Technology Series B convertible preferred stock having a stated redemption value of $2.0 million. As a result of the sale of Ventek, the Company recorded a one-time charge of approximately $2.1 million, with no tax effect, in its fiscal 2001 results.

Accordingly, the financial statements for fiscal years 2000 and 2001 reflect Ventek as a discontinued operation.

In fiscal year 2001, Ventek revenues were $4,992,000 with a pre-tax loss of $678,000. For fiscal year 2000, of which Ventek was part of the consolidated group since July 12, 2000, Ventek revenues were $1,270,000 with a pre-tax loss of $586,000.

The following assets and liabilities were reclassified as held for sale on September 30, 2001 (in thousands):

Assets held for sale:	
Cash	$ 623
Accounts receivable	752
Inventory	2,013
Intangibles	4,902
Property, plant, and equipment and other	170
Total assets held for sale	$ 8,460
Liabilities held for sale:	
Accounts payable	$ 67
Accrued payroll	178
Customer deposits	266
Deferred taxes	1,925
Total liabilities held for sale	$ 2,436

3. ACQUISITIONS

Effective June 1, 2000, the Company acquired all the outstanding stock of Farmco, Inc. and its sister company, Ro-Tech, Inc. (collectively, "Farmco"). The purchase price was $5,040,000. The Company financed the cash purchase price from cash on hand, short-term investments and existing lines of credits. The acquisition was accounted for as a purchase and Farmco's results of operations for the period subsequent to the acquisition have been included in the Company's Consolidated Statements of Earnings for the year ended September 30, 2000. On September 29, 2000 these legal entities were statutorily dissolved and merged with the Company. The purchase price has been allocated to the assets and liabilities of Farmco based on their estimated fair values. Based on these estimates, the Company recorded approximately $1,950,000 of goodwill in its consolidated balance sheet at September 30, 2000, which is being amortized on a straight-line basis over 15 years. Assets and liabilities acquired were as follows (in thousands):

Fair value of assets acquired:	
Tangible assets	$ 1,420
Patents/developed technologies and goodwill	5,091
Cash paid for common stock, less cash acquired of $453	(4,587)
Liabilities assumed	$ 1,924

The amortization period for patents/developed technologies is ten years. The product lines associated with the existing technology are expected to continue to generate revenues for an extended period of time.

Effective July 12, 2000, the Company acquired all the outstanding stock of AMVC. The Company financed the purchase of outstanding common and preferred stock by issuing $11,539,000 of Series B convertible preferred stock, $2,382,000 of Series C convertible preferred stock, $3,652,000 of warrants, and by paying cash of $11,621,000. The acquisition was accounted for as a purchase and AMVC's operations for the period subsequent to the acquisition have been included in the Company's consolidated statements of earnings for the year ended September 30, 2000. The purchase price was initially allocated to the assets and liabilities of AMVC based on their estimated fair values. In its final allocation of purchase price, the Company recorded approximately $6,200,000 of goodwill in its Consolidated Balance Sheet, which is being amortized on a straight-line basis over 15 years. Assets and liabilities acquired were as follows (in thousands):

Fair value of assets acquired:	
Tangible assets	$ 16,428
Patents/developed technologies, in-process research and development costs and goodwill	23,998
Deferred tax assets acquired	2,610
Fair value of assets acquired	43,036
Less:	
Cash paid for stock, less cash acquired of $2,877	11,621
Mandatorily redeemable preferred stock issued (both Series B and Series C)	13,921
Warrants issued	3,652
Liabilities assumed	$ 13,842

The Company obtained independent appraisals of the fair market value of the intangible assets acquired. The Company identified eight significant categories of projects under development at the date of the acquisition. None of the projects in these categories had been proven technologically feasible or had generated revenue as of the date of the evaluation. These projects are expected to generate revenue in the near future. A one-time charge of $800,000 associated with the write-off of acquired in-process research and development was recorded upon closing of the transaction.

The Company identified 11 product categories as developed technologies. The amortization period for existing products is 10 years. The product lines associated with the developed technologies are expected to continue to generate revenues for an extended period of time.

Pro forma combined statements of operations data (excluding the discontinued operation – see Note 2), is presented as if the mergers had occurred on October 1 of each year are as follows (dollars in thousands, except per share data):

	September 30,	
	2000 *	1999
Net sales	$ 82,933	$ 92,486
Net earnings (loss)	(3,957)	529
Accretion of mandatorily redeemable preferred stock	(940)	(940)
Net earnings (loss) available to common shareholders	(4,897)	(411)
Pro forma net earnings (loss) per share	(1.04)	(0.09)
Pro forma weighted average shares outstanding	4,723	4,707

**Pro forma results for the 2000 period presented include an $800,000 charge for in-process research and development resulting from the acquisition of AMVC.*

4. TRADE ACCOUNTS RECEIVABLE

Trade accounts receivable consist of the following (in thousands):

	September 30,	
	2001	2000
Trade accounts receivable	$ 13,494	$ 9,847
Allowance for doubtful accounts	(422)	(421)
Total trade accounts receivable, net	$ 13,072	$ 9,426

5. INVENTORIES

Inventories consist of the following (in thousands):

	September 30, 2001	September 30, 2000
Purchased components and raw materials	$ 6,099	$ 7,964
Sub-assemblies	2,758	2,941
Work-in-process	3,299	4,343
Finished goods	2,305	6,763
Total inventories	$ 14,461	$ 22,011

6. PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consist of the following (in thousands):

	September 30, 2001	September 30, 2000
Land	$ 1,407	$ 1,768
Buildings and improvements	7,236	7,364
Manufacturing equipment	11,910	11,213
Office equipment, furniture, and fixtures	11,971	11,657
Equipment purchases in process	-	433
	32,524	32,435
Accumulated depreciation	(21,088)	(18,651)
Total property, plant, and equipment - net	$ 11,436	$ 13,784

7. FINANCING AGREEMENTS

At September 30, 2001, the Company had a domestic credit accommodation with a commercial bank which provided for revolving credit loans and an operating line up to $4,500,000. The operating line expired November 30, 2001 and was repaid. Borrowings under the operating line were $2,000,000 and zero at September 30, 2001 and 2000, respectively.

In January 2002, the Company completed the refinancing of its domestic credit accommodation. The accompanying balance sheet as of September 30, 2001 reflects the effect of this refinancing and the new scheduled debt maturities. The refinanced domestic credit accommodation is secured by all of the personal property of the Company and contains covenants which require the maintenance of a debt service coverage ratio and limit capital expenditures.

Long-term debt consists of the following (in thousands):

	September 30,	
	2001	2000
Revolving credit facility dated January 2002, variable interest payable monthly at the bank's prime rate plus 2% per annum (6.75% at January 7, 2002), due November 30, 2002. Total borrowings available based on the lesser of $10,000,000 or the available borrowing base, which is based on varying percentages of eligible accounts receivable and inventories. Secured by business personal property.	$ 7,733	$ -
Term loan dated January 2002, variable interest payable monthly at the bank's prime rate plus 2% per annum (6.75% at January 7, 2002), due in quarterly principal payments of $500,000 plus 50% of excess cash flow, as defined, subject to minimum payments through October 15, 2003. Secured by business personal property.	6,500	-
Revolving credit agreement, variable interest rate (5.6% at September 30, 2001), due in quarterly installments, secured by business personal property. Refinanced by credit agreement dated January 2002.	-	10,000
Revolving credit agreement, variable interest rate (5.6% at September 30, 2001), due in quarterly installments, secured by business personal property. Refinanced by credit agreement dated January 2002.	-	8,150
Mortgage note payable, interest of 8.3%, due in monthly principal and interest installments through May 2008, secured by certain land and buildings.	2,859	2,905
Notes payable, interest rate of 11.25%, due in quarterly interest installments through April 2001. The principal amount is payable in April 2001.	-	900
Note payable, interest rate of 6%, due in quarterly principal and interest installments through October 2006, secured by certain land and buildings.	347	400
Note payable to Veneer Technology, Inc. (which is owned by a former director and certain former employees of the Company), interest of 6.75%, due in July 2001.	-	250
Note payable, interest rate of 5.625%, due in quarterly principal and interest installments through October 2001, secured by receivables.	21	100
Capital leases, interest rates between 6% and 11%, due in principal and interest installments through September 2005, secured by certain office and manufacturing equipment.	860	225
	18,320	22,930
Current portion	(11,739)	(3,447)
Total long-term debt	$ 6,581	$ 19,483

Principal payments on long-term debt are as follows (in thousands):

September 30,	
2002	$ 11,739
2003	2,954
2004	668
2005	242
2006	135
Thereafter	2,582
Total	$ 18,320

Based on the borrowing rates currently available to the Company for loans with similar terms and average maturities, the fair value of long-term debt at September 30, 2001 approximates carrying value.

8. LEASES

The Company has agreements with the Port of Walla Walla to lease two operating facilities which expire in 2010. The Company currently has the option to purchase the land and plant under both of the agreements. The purchase price of one facility is determined by reducing the original plant construction costs of approximately $8,800,000 by one thirty-fifth for each lease year prior to the exercise of the option and adding $600,000 for the land, subject to further reductions if exercised after the fifteenth year of the lease. The other facility may be purchased, commencing January 1, 2002, at the appraised fair market value. The Company also has a leased operating facility in Oregon. This lease expires in 2003 and is owned by a current employee of the Company. The Company has leased an operating facility in The Netherlands. This lease expires in 2008.

Rent expense is recognized on a straight-line basis over the term of the lease. Rental expense for the Company's operating leases referred to above was $1,202,000 for the year ended September 30, 2001, $1,152,000 for the year ended September 30, 2000, and $1,133,000 for the year ended September 30, 1999. Rental expense on the leased operating facility in Oregon which is owned by an employee of the Company was $120,000, $40,000, and zero for the years ended September 30, 2001, 2000, and 1999, respectively.

The following is a schedule of future minimum rental payments required under the operating leases and future rental expense (in thousands):

Year Ending September 30,	Rental Payments	Rental Expense
2002	$ 1,179	$ 1,194
2003	1,162	1,154
2004	1,108	1,074
2005	1,135	1,074
2006	1,170	1,083
Thereafter	4,342	4,010
Total	$ 10,096	$ 9,589

9. MANDATORILY REDEEMABLE PREFERRED STOCK AND WARRANTS

The Company issued 1,340,366 shares of Series B convertible preferred stock ("Series B") at a price of \$8.60 per share in conjunction with the acquisition of AMVC (see Note 3). Series B is convertible at the option of the holder at any time, unless previously redeemed, or by the company upon a merger, consolidation, share exchange or sale of substantially all of its assets. The Series B, par value of \$0.01 per share, may be converted into 2/3 of a share of common stock. The holders of Series B may require the Company to repurchase any or all of their shares at any time after July 12, 2002 at the redemption price of \$10.00. If not converted to common stock or redeemed at the option of the Series B holder after July 12, 2002, the Company must redeem the Series B for \$10.00 per share on July 12, 2005. The Series B is being accreted from its issue price to its scheduled redemption price using the effective interest method.

The holders of Series B are entitled to vote on all matters based on the number of whole shares of common stock into which the holder's stock could be converted. The holders of Series B are not entitled to any dividends. In the event of any liquidation, dissolution, or winding up of the company's business, the holders of Series B would be entitled to a payment of \$10.00 per share before any amount is distributed to holders of common stock. If assets were insufficient to permit this payment to the holders of Series B, the entire assets available for distribution to holders of capital stock would be distributed ratably among the holders of Series B.

The Company also issued 119,106 shares of Series C convertible preferred stock ("Series C") at a price of \$20.00 per share in conjunction with the acquisition of AMVC (see Note 3). In fiscal year 2001, the Series C shareholder redeemed the entire outstanding amount of its shares and warrants.

Also, the Company issued 365,222 warrants at a fair market value of \$10.00 per warrant in conjunction with the issuance of the convertible preferred stock. Each warrant entitles its holder to purchase at any time for a period of five years from July 12, 2001 one share of common stock at \$15.00 per share, subject to certain adjustments. The warrants permit the holder to engage in a net exercise of the warrants if the fair market value of one share of common stock is greater than \$15.00 per share on the date of exercise. Prior to the expiration date of the warrant, the holder may require the Company to redeem the warrant for cash at a price equal to \$10.00 for each whole share of common stock that may be purchased under the warrant. The warrant holders do not have the right to vote or participate in any other matters as shareholders.

If all holders were to redeem their preferred stock and warrants at the earliest possible time, the cash requirements would be \$805,000 presently and an additional \$11.4 million in July 2002. The Company's ability to make cash payments with respect to such equity redemption obligations and to satisfy or refinance its other debt obligations will in part depend upon its future operating performance. The Company believes, based on current circumstances, that its cash flow from operations, together with anticipated available borrowings under its new revolving credit facility, will not be sufficient to permit it to pay in full its potential equity redemption obligations in July 2002. As a result, the Company will be required to pursue alternatives that may include reducing or delaying capital expenditures, selling assets, restructuring or refinancing present debt, restructuring the terms of the preferred stock, or seeking additional subordinated debt or equity capital. The Company anticipates operating results sufficient to support the availability of these or other alternatives.

10. INCOME TAXES

The provision (benefit) for income taxes consists of the following (in thousands):

	Year Ended September 30,		
	2001	2000	1999
Current:			
Federal	$ -	$ (906)	$ 1,520
State	-	(49)	142
	-	(955)	1,662
Deferred:			
Federal	(1,247)	736	(32)
State	(96)	51	2
	(1,343)	787	(30)
Total income tax expense (benefit)	$ (1,343)	$ (168)	$ 1,632

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities are as follows (in thousands):

	September 30,	
	2001	2000
Deferred tax asset:		
Reserves and accruals	$ 2,091	$ 1,807
NOL carryforward	8,150	6,301
Translation adjustment to equity	620	636
Deferred tax liability:		
Accumulated depreciation	(127)	(148)
Intangible assets	(3,775)	(6,183)
Net deferred tax asset	$ 6,959	$ 2,413
Deferred tax:		
Current asset	$ 1,884	$ 1,699
Long-term asset	5,376	1,237
Long-term liability	(301)	(523)
Net deferred tax asset	$ 6,959	$ 2,413

Income tax expense (benefit) is computed at rates different than statutory rates. The reconciliation between effective and statutory rates is as follows:

	Year Ended September 30,		
	2001	2000	1999
Statutory rates	(34.0)%	(34.0)%	34.0 %
Increase (reduction) in income taxes resulting from:			
FSC commissions	(3.5)	(87.7)	(5.0)
FSC tax	-	30.3	1.7
R&D credit	(1.6)	(47.5)	-
State income taxes, net of federal benefit	(1.7)	(1.6)	1.8
Other permanent differences	4.3	3.3	(0.9)
Income tax combined effective rate	(36.5)%	(137.2)%	31.6 %

At September 30, 2001, there were $23.4 million of net operating loss carryforwards which expire between 2004 and 2021, $76,000 of research and development credit carryforwards which expire between 2020 and 2021, $340,000 of foreign tax credit carryforwards which expire between 2005 and 2006, and $74,000 of AMT credit carryforwards which do not expire.

11. SHAREHOLDERS' EQUITY

Employee Stock Purchase Plan – Most employees are eligible to participate in the Company's Employee Stock Purchase Plan (the "Plan"). Shares are not available to employees who already own 5% or more of the Company's stock. Employees can withhold, by payroll deductions, up to 5% of their regular compensation to purchase shares at a purchase price of 85% of the fair market value of the common stock on the purchase date. There were 500,000 shares reserved for purchase under the Plan. During the years ended September 30, 2001, 2000, and 1999, the Company issued shares totaling 17,184, 8,065, and 12,393, respectively, under the Plan.

Employees' Stock Option Plan – Under the 1996 Employees' Stock Option Plan (the "1996 Plan"), eligible employees may receive either incentive stock options or nonstatutory stock options and such options may be exercised only after an employee has remained in continuous employment for one year after the date of grant. Thereafter, the options become exercisable as stipulated by the individual option agreements, generally 25% per year on the anniversary date of the grant. The option price is determined to be fair market value at date of grant. The following table summarizes activity under this Plan:

	Outstanding Options	
	Number of Shares	Weighted Average Price Per Share
Balance at October 1, 1998	602,783	$ 15.19
Options granted	45,000	$ 8.23
Options exercised	(100)	$ 7.00
Options forfeited	(91,700)	$ 16.09
Balance at September 30, 1999	555,983	$ 14.48
Options granted	298,250	$ 8.84
Options exercised	(11,500)	$ 7.00
Options forfeited	(117,900)	$ 14.96
Balance at September 30, 2000	724,833	$ 12.20
Options granted	40,000	$ 7.89
Options exercised	-	-
Options forfeited	(65,400)	$ 13.21
Balance at September 30, 2001	699,433	$ 11.86

At September 30, 2001, the total number of shares reserved for option exercises was 1,187,483, of which 488,050 were available for grant. At that date, options for 410,066 shares were exercisable at prices from $7.00 to $23.25 per share. At September 30, 2000, the total number of shares reserved for option exercises was 1,187,483, of which 462,650 were available for grant. At that date, options for 326,418 shares were exercisable at prices from $7.00 to $23.25 per share. At September 30, 1999, the total number of shares reserved for option exercises was 698,983, of which 143,000 were available for grant. At that date, options for 320,780 shares were exercisable at prices from $7.00 to $23.25 per share.

During 1995, FASB issued SFAS No. 123, *Accounting for Stock-Based Compensation*, which defines a fair value based method of accounting for employee stock options and similar equity instruments and encourages all entities to adopt that method of accounting for all of their employee stock compensation plans. However, it also allows an entity to continue to measure compensation cost for those plans using the method of accounting prescribed by Accounting Principles Board Opinion No. 25 ("APB 25"). Entities electing to remain with the accounting in APB 25 must make pro forma disclosures of net income and, if presented, earnings per share, as if the fair value based method of accounting defined in SFAS No. 123 has been adopted.

The Company has elected to account for its stock-based compensation plans under APB 25. The Company has computed, for pro forma disclosure purposes, the value of all stock and stock options granted under the Employee Stock Purchase Plan and the 1996 Employees' Stock Option Plan during 2001, 2000, and 1999 using the Black-Scholes option pricing model as prescribed by SFAS No. 123 using the following weighted average assumptions for the years ended September 30, 2001, 2000, and 1999:

	2001	2000	1999
Risk-free interest rate	3.7 %	6.2 %	5.0 %
Expected dividend yield	0 %	0 %	0 %
Expected lives	5.5 years	5.5 years	6 years
Expected volatility	71 %	66 %	66 %

Using the Black-Scholes methodology, the total value of stock options granted during 2001, 2000, and 1999 was $192,000, $1,598,000, and $225,000, respectively, which would be amortized on a pro forma basis over the vesting period of the options (typically five years). The weighted average fair value of options granted under the 1996 Employees' Stock Option Plan during 2001, 2000, and 1999 was $5.03 per share, $5.60 per share, and $5.28 per share, respectively.

The total compensatory value of stock purchased under the Employee Stock Purchase Plan during 2001, 2000, and 1999 was $12,000, $11,000, and $13,000, respectively. The weighted average fair value of the stock purchased during 2001, 2000, and 1999 was $0.73 per share, $1.34 per share, and $1.08 per share, respectively.

If the Company had accounted for its 1996 Plan and Employee Stock Purchase Plan in accordance with SFAS No. 123, the Company's net earnings and earnings per share would approximate the pro forma disclosures below (in thousands, except per share amounts):

	Year Ended September 30, 2001		Year Ended September 30, 2000		Year Ended September 30, 1999	
	As Reported	Pro Forma	As Reported	Pro Forma	As Reported	Pro Forma
Net earnings (loss)	$ (4,924)	$ (5,542)	$ (333)	$ (1,083)	$ 3,529	$ 2,633
Earnings (loss) per share - basic and diluted	$ (1.24)	$ (1.37)	$ (0.12)	$ (0.28)	$ 0.75	$ 0.56

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts. SFAS No. 123 does not apply to awards prior to October 1, 1995, and additional awards are anticipated in future years.

The following table summarizes information about stock options outstanding at September 30, 2001:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number of Shares Exercisable	Weighted Average Exercise Price
$7.00 - 10.00	408,483	4.5	$ 8.59	144,794	$ 8.47
$10.01 - 15.00	117,700	6.2	11.69	92,022	11.67
$15.01 - 20.00	94,450	5.4	17.24	94,450	17.24
$20.01 - 23.25	78,800	4.6	22.58	78,800	22.58
$7.00 - 23.25	699,433	4.9	$ 11.86	410,066	$ 13.92

12. EMPLOYEE BENEFIT PLANS

The Company has a 401(k) profit sharing plan which covers substantially all employees. The Company is required to match 50% of employee contributions up to 2% of each participating employee's compensation. The Company contributed $331,000, $257,000, and $200,000 in matching funds to the plan for the years ended September 30, 2001, 2000, and 1999, respectively.

The 401(k) plan also permits the Company to make discretionary profit sharing contributions to all employees. Discretionary profit sharing contributions are determined annually by the Board of Directors. Profit sharing plan expense was zero, zero, and $506,000 for the years ended September 30, 2001, 2000, and 1999, respectively.

13. SEGMENT INFORMATION

The Company's business units serve customers in its primary market – the food processing and agricultural products industry – through common sales and distribution channels. Therefore, the Company reports on one segment. The following is information about products and services (in thousands).

	Year Ended September 30,		
	2001	2000	1999
Net sales by product category:			
Automated inspection systems	$ 26,884	$ 24,002	$ 22,342
Process systems	27,050	26,414	33,950
Parts and service/contracts	19,020	16,996	13,239
Total net sales by product category	$ 72,954	$ 67,412	$ 69,531

Net sales for service/contracts were less than 10% of total net sales for the years ended September 30, 2001, 2000, and 1999, respectively.

The following is information about geographic areas:

	Year Ended September 30,		
	2001	2000	1999
Net sales:			
Domestic	$ 37,496	$ 40,030	$ 37,844
International	35,458	27,382	31,687
Total net sales	$ 72,954	$ 67,412	$ 69,531
Long-lived assets:			
Domestic	$ 26,995	$ 38,306	$ 6,192
International	3,031	3,332	4,007
Total long-lived assets	$ 30,026	$ 41,638	$ 10,199

During fiscal 2001, 2000, and 1999, net sales to one major customer amounted to approximately 17%, 14% and 11% of total net sales, respectively.

During 2001, net sales to various customers in France accounted for approximately 10% of total net sales. No single geographic location accounted for more than 10% of net sales during 2000. During 1999, net sales to various customers in Canada accounted for approximately 11% of total net sales. Location of the customer is the basis for the categorization of net sales.

14. ROYALTY INCOME

As part of a settlement agreement entered into during 1997, the Company may receive royalty payments through 2001 related to the sale of certain equipment to a selected market. The payment may be reduced by a percentage of the purchases of equipment from the Company by the other party. The Company recognized royalty income from this agreement of $122,000, $71,000, and $26,000 during the years ended September 30, 2001, 2000, and 1999, respectively.

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SUPPLEMENTARY DATA

QUARTERLY FINANCIAL INFORMATION *(Unaudited)*

The following is a summary of operating results by quarter for the years ended September 30, 2001 and 2000 (in thousands, except per share data):

2001 Quarter Ended	December 31,	March 31,	June 30,	September 30,	Total
Net sales	$ 18,767	$ 18,359	$ 20,518	$ 15,310	$ 72,954
Gross profit	7,156	5,739	8,156	4,717	25,768
Net earnings (loss) from continuing operations	(391)	(1,401)	585	(1,136)	(2,343)
Net earnings (loss) from discontinued operation	101	(419)	157	(2,420)	(2,581)
Net earnings (loss)	(290)	(1,820)	742	(3,556)	(4,924)
Net earnings (loss) from continuing operations per share - basic	(0.13)	(0.35)	0.08	(0.29)	(0.69)
Net earnings (loss) from continuing operations per share - diluted	(0.13)	(0.35)	0.07	(0.29)	(0.69)
Net earnings (loss) from discontinued operations per share - basic and diluted	0.02	(0.08)	0.03	(0.51)	(0.55)
Net earnings (loss) per share - basic	(0.11)	(0.43)	0.11	(0.80)	(1.24)
Net earnings (loss) per share - diluted	(0.11)	(0.43)	0.10	(0.80)	(1.24)

2000 Quarter Ended	December 31,	March 31,	June 30,	September 30,	Total
Net sales	$ 15,421	$ 17,387	$ 17,035	$ 17,569	$ 67,412
Gross profit	5,453	6,453	6,929	6,165	25,000
Net earnings (loss) from continuing operations	90	834	1,196	(2,074)	46
Net earnings (loss) from discontinued operation	-	-	-	(379)	(379)
Net earnings (loss)	90	834	1,196	(2,453)	(333)
Net earnings (loss) from continuing operations per share - basic and diluted	0.02	0.18	0.25	(0.49)	(0.04)
Net earnings (loss) from discontinued operations per share - basic and diluted	-	-	-	(0.08)	(0.08)
Net earnings (loss) per share - basic and diluted	0.02	0.18	0.25	(0.57)	(0.12)

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

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

There is hereby incorporated by reference the information under the captions "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive Proxy Statement to be filed pursuant to Regulation 14A, which Proxy Statement is anticipated to be filed with the Securities and Exchange Commission within 120 days after the end of Registrant's fiscal year ended September 30, 2001.

ITEM 11. EXECUTIVE COMPENSATION.

There is hereby incorporated by reference the information under the caption "Executive Compensation" in the Company's definitive Proxy Statement to be filed pursuant to Regulation 14A, which Proxy Statement is anticipated to be filed with the Securities and Exchange Commission within 120 days after the end of Registrant's fiscal year ended September 30, 2001.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

There is hereby incorporated by reference the information under the caption "Principal Shareholders" in the Company's definitive Proxy Statement to be filed pursuant to Regulation 14A, which Proxy Statement is anticipated to be filed with the Securities and Exchange Commission within 120 days after the end of Registrant's fiscal year ended September 30, 2001.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

There is hereby incorporated by reference the information under the caption "Certain Relationships and Related Transactions" in the Company's definitive Proxy Statement to be filed pursuant to Regulation 14A, which Proxy Statement is anticipated to be filed with the Securities and Exchange Commission within 120 days after the end of Registrant's fiscal year ended September 30, 2001.

PART IV

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

PAGE

(a) The following documents are filed as part of this report:

1. Financial Statements:

   Reference is made to Part II, Item 8, for a listing of required financial statements filed with this report 26

2. Financial Statement Schedules:

   Financial statement schedules are omitted because they are not applicable or the required information is included in the accompanying consolidated financial statements or notes thereto.

3. Exhibits:

(3) Articles of Incorporation and Bylaws

(3.1) Restated Articles of Incorporation (filed as Exhibit 3.1 to the Registration Statement on Form S-1 (Registration No. 33-63194) filed with the Securities and Exchange Commission on May 24, 1993 and incorporated herein by reference)

(3.2) Restated Bylaws, as amended (filed as Exhibit 3.2 to the Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1993 and incorporated herein by reference)

(10) Material contracts

(10.1) Construction and Lease Agreement dated October 17, 1989 between the Port of Walla Walla and Registrant (filed as Exhibit 10.1 to the Registration Statement on Form S-1 (Registration No. 33-63194) filed with the Securities and Exchange Commission on May 24, 1993 and incorporated herein by reference)

(10.2) Indenture of Trust dated as of February 1, 1993 between Port of Walla Walla Public Corporation and Key Bank of Washington, as Trustee (filed as Exhibit 10.2 to the Registration Statement on Form S-1 (Registration No. 33-63194) filed with the Securities and Exchange Commission on May 24, 1993 and incorporated herein by reference)

(10.3) Loan Agreement dated February 1, 1993 between Port of Walla Walla Public Corporation and Registrant (filed as Exhibit 10.3 to the Registration Statement on Form S-1 (Registration No. 33-63194) filed with the Securities and Exchange Commission on May 24, 1993 and incorporated herein by reference)

(10.4) Pledge and Security Agreement dated as of February 1, 1993 between Registrant and U.S. Bank of Washington, N.A. (filed as Exhibit 10.4 to the Registration Statement on Form S-1 (Registration No. 33-63194) filed with the Securities and Exchange Commission on May 24, 1993 and incorporated herein by reference)

(10.5)* Registrant's 1989 Employees' Stock Option Plan, as amended (filed as Exhibit 10.5 to the Registration Statement on Form S-1 (Registration No. 33-63194) filed with the Securities and Exchange Commission on May 24, 1993 and incorporated herein by reference)

(10.6)* Registrant's 401(k) Profit Sharing Plan dated May 11, 1992 (filed as Exhibit 10.6 to Amendment No. 1 to Form S-1 (Registration No. 33-63194) filed with the Securities and Exchange Commission on May 24, 1993 and incorporated herein by reference)

(10.7)* Registrant's Restated Phantom Stock Plan, as amended (filed as Exhibit 10.7 to the Registration Statement on Form S-1 (Registration No. 33-63194) filed with the Securities and Exchange Commission on May 24, 1993 and incorporated herein by reference)

(10.8) License Agreement effective July 1, 1992 between Registrant and Simco/Ramic Corporation (filed as Exhibit 10.8 to the Registration Statement on Form S-1 (Registration No. 33-63194) filed with the Securities and Exchange Commission on May 24, 1993 and incorporated herein by reference)

(10.9)* Registrant's Restated 1989 Employees' Stock Option Plan, as amended (filed as Exhibit 10.1 to the Form 10-Q filed with the Securities and Exchange Commission on May 12, 1995 and incorporated herein by reference)

(10.10)* Registrant's 1996 Employees' Stock Option Plan (filed as Exhibit 10.1 to the Form 10-Q filed with the Securities and Exchange Commission on May 2, 1996 and incorporated herein by reference)

(10.11)* Registrant's 1996 Employees Stock Purchase Plan (filed as Exhibit 10.2 to the Form 10-Q filed with the Securities and Exchange Commission on May 2, 1996 and incorporated herein by reference)

(10.12) Lease Agreement dated April 18, 1996 between the Port of Walla Walla and Registrant (filed as Exhibit 10.1 to the Form 10-Q filed with the Securities and Exchange Commission on August 7, 1996 and incorporated herein by reference)

(10.13) Business Loan Agreement dated as of January 25, 1999 between Registrant and U.S. Bank National Association (filed as Exhibit 10.1 to the Form 10-Q filed with the Securities and Exchange Commission on May 14, 1999 and incorporated herein by reference)

(10.14) Agreement and Plan of Merger by and among the Registrant, KTC Acquisition Corp. and Advanced Machine Vision Corporation dated February 15, 2000 as amended by Amendment No. 1 dated February 25, 2000 and as amended by Amendment No. 2 dated April 24, 2000 (filed as Exhibit 2.1 to the Form 8-K filed with the Securities and Exchange Commission on July 27, 2000 and incorporated herein by reference)

(10.15) Stock Purchase Agreement by and among the Registrant, Farmco, Inc., Ro-Tech, Inc., John E. Mobley and Nancy L. Mobley dated May 16, 2000 (filed as Exhibit 2.1 to the Form 8-K filed with the Securities and Exchange Commission on May 31, 2000 and incorporated herein by reference)

(10.16) Promissory Note dated April 24, 1998 between SRC Vision, Inc. and Bank of America National Trust & Savings Association (filed as Exhibit 10.17 to Form 10-K filed with the Securities and Exchange Commission on December 19, 2000 and incorporated herein by reference)

(21) List of Subsidiaries

(23) Consent of Deloitte & Touche LLP

(99) Forward-Looking Statement Risk and Uncertainty Factors

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* Management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K

1. No reports on Form 8-K were filed by the Registrant during the last quarter of the fiscal year ended September 30, 2001.

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.

KEY TECHNOLOGY, INC.

By: /s/ Thomas C. Madsen
Thomas C. Madsen
Chairman and Chief Executive Officer

By: /s/ Ted R. Sharp
Ted R. Sharp
Chief Financial Officer
(Principal Financial and Accounting Officer)

January 15, 2002

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ Thomas C. Madsen Thomas C. Madsen, Chairman and Chief Executive Officer	January 15, 2002
/s/ Harold R. Frank Harold R. Frank, Director	January 15, 2002
/s/ John E. Pelo John E. Pelo, Director	January 15, 2002
/s/ Michael L. Shannon Michael L. Shannon, Director	January 15, 2002
/s/ Peter H. van Oppen Peter H. van Oppen, Director	January 15, 2002
/s/ Gordon Wicher Gordon Wicher, Director	January 15, 2002
/s/ Ted R. Sharp Ted R. Sharp, Chief Financial Officer (Principal Financial and Accounting Officer)	January 15, 2002