

K E Y T E C H N O L O G Y
L E T T E R T O S H A R E H O L D E R S

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Dear Shareholder,

This year proved to be an exciting year at Key Technology—one that we believe will prove to be a significant turning point in the Company's history. We invested in new markets and geographies; and we made progress toward our long-term growth goal. Our successes in 2005 have positioned us well to pursue the opportunities we see on the horizon.

New orders increased, parts and service grew, and our balance sheet is strong

Total revenues for fiscal 2005 totaled \$80.3 million, with net earnings of \$2.7 million. Several bright spots stand out in the financial results for the year: new orders were up more than 15% from the prior year; parts and service revenues showed strong growth once again, increasing 15% from fiscal year 2004; and we had strong cash flow, strengthening our balance sheet for future investment opportunities.

Our plan for the future moves ahead

In 2005, we focused our efforts on three major initiatives to achieve our long-term revenue growth plan: expand and grow our participation in the **Pharmaceutical** market; continue to drive growth in our **Aftermarket** business; and strengthen and grow our business in **China**.

We are pleased to report that we made good progress on each of these initiatives in fiscal 2005. Some of our efforts are early stage investments where the financial rewards may not be realized for several years, while others, particularly our investments in new product development, are already contributing to our bottom line.

Pharmaceutical Focus

In 2005 we formed SYMETIX™ as a new business unit to focus our efforts in the pharmaceutical market. The SYMETIX business unit is a team of Key employees who are fully

dedicated to the development and growth of our business in this market. Traction during the year was also reflected by a new product introduction and the launch of a new application for one of our current products.

Vantyx™ is a new optical inspection system targeted at high-resolution inspection applications for solid-dose pharmaceuticals. We installed our first system at an Ortho-McNeil facility in Puerto Rico in early summer 2005, and have been very pleased with the feedback from the customer. We have high hopes for Vantyx.

In addition, near fiscal year-end we received a substantial order from one of the major manufacturers in the nutraceutical market for a complete softgel finishing line. This line incorporates advanced adaptations of our existing patented high-resolution inspection technology and material handling systems to provide a complete solution to “end-of-line” finishing of softgels. We expect this concept to be very successful in the market, as it allows a traditional collection of batch-oriented, manually intensive processes to be replaced with continuous automation—eliminating labor, reducing inventory, improving product quality and enhancing product safety and security.

Aftermarket Business

In 2005, our strong growth in the aftermarket business continued, with revenues up 15% over 2004. A key to our success in this area was our line of upgrade products, particularly our ADR4c upgrade for potato processors. Upgrades are an integral part of our future growth plans in the aftermarket business. We introduced several upgrade products that allow our customers to equip their current inspection systems with our G6 vision engine technology. The G6 upgrade family of products is an important element of our aftermarket plans.

China

The market in China holds tremendous opportunities for our products. In recent years, we have built a successful business providing

inspection systems for tobacco processing customers in China and we believe that a larger opportunity exists in food processing. In addition, we think opportunities exist to expand our sourcing of components and technologies for our products to include suppliers in China.

Our efforts in China in 2005 were focused on building capabilities in-country to provide sales, service and applications support as the foundation for our commitment to increase our business there.

We are confident that these three primary initiatives will power Key Technology's future success. We expect to make on-going investments to support our efforts in each of these three areas of focus, including investments in both organic product and market development efforts and in external partnerships and acquisitions—all initiatives we are prepared to undertake in the years ahead.

We've strengthened Key Technology for the road ahead

We took several steps in 2005 to strengthen the Company and enhance our competitive position.

The most significant is that we added three very capable and experienced senior executives to the management team: John Boutsikaris, Senior Vice President of Sales and Marketing; Ron Burgess, Senior Vice President and Chief Financial Officer; and Craig Miller, Senior Vice President and General Manager Aftermarket Business.

During the fiscal year, we introduced Raptor Laser Technology as the newest sensor for use in our inspection systems. This new sensing capability allows us to solve an even greater number of application challenges for our customers.

In February, we completed the acquisition of Freshline Machines Pty Ltd to give us a strong foothold in the fast-growing fresh-cut vegetable and fruit market.

Mid-year, we announced plans to consolidate our two Walla Walla facilities into one operation.

This consolidation will significantly improve our cost structure through reduced production overhead and will increase the efficiency of our manufacturing operations by more effectively utilizing machinery and labor. The combined facility will provide sufficient capacity to support the Company's growth plans.

On December 31, 2005, Kirk Morton, CEO, took a new position in another company. The board has appointed a search committee to recruit a replacement. In the meantime, we are confident in the capabilities of our management team to execute Key's strategies without loss of momentum.

These are times of great opportunity for Key, and we are optimistic about our future. We made solid progress in 2005 in positioning and strengthening the Company for the course that we have charted.

We are grateful to our employees who have worked very hard to get these initiatives underway and for their tireless work to support our customers. We also extend our thanks to you, our shareholders, for your continued support and interest in Key Technology.



Tom Madsen
Chairman of the Board

John Boutsikaris
Senior Vice President of Sales and Marketing

Ron Burgess
Senior Vice President and Chief Financial Officer

Craig Miller
Senior Vice President and
General Manager of Aftermarket Business

Gordon Wicher
Senior Vice President and
General Manager of Americas and Asia

Directors & Officers

John C. Boutsikaris
Senior Vice President of
Sales and Marketing

Ronald W. Burgess
Senior Vice President and
Chief Financial Officer

Thomas C. Madsen
Chairman of the Board

Craig T.J. Miller
Senior Vice President and
General Manager of
Aftermarket Business

John E. Pelo^{1,3}
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President and Chief
Executive Officer,
Swire Coca-Cola USA

Michael L. Shannon^{2,3}
Director
Principal, General Counsel
Law Firm

Charles H. Stonecipher^{1,3}
Director
Executive Vice President of
Product Development and
Strategy,
Advanced Digital
Information Company

Donald A. Washburn^{1,2,3}
Director
Private Investor
Director, Amedisys, Inc.
Director,
The Greenbrier Companies
Trustee,
LaSalle Hotel Properties

Gordon Wicher
Secretary
Senior Vice President and General
Manager of Americas and Asia

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Stock Listings

Key Technology, Inc.,
common stock trades on the
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the symbol KTEC.

Corporate Information

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Shareholder Information

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Annual Meeting Of Shareholders:
8:00 a.m., Wednesday,
February 8, 2006
Key Technology
Corporate Headquarters

¹ Member of the Audit Committee of the Board of Directors

² Member of the Compensation Committee of the Board of Directors

³ Member of the Nominating and Corporate Governance Committee of the Board of Directors

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, 2005.