KEY TECHNOLOGY INC
Form 10-K
December 13, 2013

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

FORM 10-K

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2013

OR

o 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 (State or jurisdiction of incorporation or organization)	93-0822509 (I.R.S. Employer Identification No.)
150 Avery Street Walla Walla, Washington (Address of Principal Executive Offices)	99362 (Zip Code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, no par value Preferred Stock Purchase Right	The NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ¨ No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ¨ No ý

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 ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes ý 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. ¨

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

Large accelerated filer o	Accelerated filer ý
Non-accelerated filer o (Do not check if a smaller reporting company.)	Smaller reporting company o

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

The aggregate market value of the Registrant's common stock held by non-affiliates on March 31, 2013 (based on the last sale price of such shares) was approximately $69,118,000.

There were 6,281,682 shares of the Registrant's common stock outstanding on December 6, 2013.

DOCUMENTS INCORPORATED BY REFERENCE

Parts of Registrant's Proxy Statement, dated on or about January 2, 2014, prepared in connection with the Annual Meeting of Shareholders to be held on February 5, 2014, are incorporated by reference into Part III of this Report.

KEY TECHNOLOGY, INC.
2013 ANNUAL REPORT ON FORM 10-K
TABLE OF CONTENTS

INFORMATION CONCERNING FORWARD-LOOKING STATEMENTS

From time to time, Key Technology, Inc. (“we," "us" or "our"), through its management, may make forward-looking public statements with respect to the company regarding, among other things, expected future revenues or earnings, projections, plans, future performance, product development and commercialization, and other estimates relating to our future operations. Forward-looking statements may be included in reports filed under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), in press releases or in oral statements made with the approval of an authorized executive officer of the company. The words or phrases “will likely result,” “are expected to,” “intends,” “is anticipated,” “estimates,” “believes,” “projects” or similar expressions are intended to identify “forward-looking statements” within the meaning of Section 21E of the Exchange Act and Section 27A of the Securities Act of 1933, as amended, as enacted by the Private Securities Litigation Reform Act of 1995.

Forward-looking statements are subject to a number of risks and uncertainties, the occurrence of any of which could cause the price of our common stock to fluctuate significantly, making it difficult for shareholders to resell common stock at a time or price they find attractive. We caution investors not to place undue reliance on our forward-looking statements, which speak only as to the date on which they are made. Our actual results may differ materially from those described in the forward-looking statements as a result of various factors, including those listed below:

- changes in general economic conditions and disruption in financial markets may adversely affect the business of our customers and our business and results of operations;
- ongoing uncertainty and volatility in the global financial markets may adversely affect our operating results;
- discord, conflict, and lack of compromise within and between the executive and legislative branches of the U.S. government related to federal government budgeting, taxation policies, government expenditures, and U.S. borrowing/debt ceiling limits could adversely affect our business and operating results;
- economic conditions in the food processing industry, either globally or regionally, may adversely affect our revenues;
- the loss of any of our significant customers could reduce our revenues and profitability;
- significant investments in unsuccessful research and development efforts could materially adversely affect our business;
- industry consolidation could increase competition in the food processing equipment industry;
- we are subject to price competition that may reduce our profitability;
- the significance of major orders could result in significant fluctuation in quarterly operating results;
- the failure of our independent sales representatives to perform as expected would harm our net sales;
- we have made, or may make, acquisitions, or enter into distribution agreements or similar business relationships that could disrupt our operations and harm our operating results;
- our international operations subject us to a number of risks that could adversely affect our revenues, operating results and growth;
- fluctuations in foreign currency exchange rates could result in unanticipated losses that could adversely affect our liquidity and results of operations;
- advances in technology by competitors may adversely affect our sales and profitability;
- our existing and new products may not compete successfully in either current or new markets, which would adversely affect our sales and operating results;
- our expansion into new markets, increasingly complex projects and applications, and integrated product offerings could increase our cost of operations and reduce gross margins and profitability;
- our inability to obtain products and components from suppliers would adversely affect our ability to manufacture and market our products;
- our information systems, computer equipment and information databases are critical to our business operations, and any damage or disruptions could adversely affect our business and results of operations;
-

our potential inability to retain and recruit experienced management and other key personnel, or the loss of key management personnel, may adversely affect our business and prospects for growth;

- the potential inability to protect our intellectual property, especially as we expand geographically, may adversely affect our competitive advantage;
- intellectual property-related litigation expenses and other costs resulting from infringement claims asserted against us by third parties may adversely affect our results of operations and our customer relations;
- our subsidiary Visys N.V. is involved in ongoing litigation that may result in an adverse outcome, and regardless of the outcome we will be forced to expend resources as a participant in the litigation;
- our dependence on certain suppliers may leave us temporarily without adequate access to raw materials or products;
- our operating results are seasonal and may further fluctuate due to severe weather conditions affecting the agricultural industry in various parts of the world;
- the limited availability and possible cost fluctuations of materials used in our products could adversely affect our gross margins;

- compliance with recently passed health care legislation and increases in the cost or providing health care plans to our employees may adversely affect our business;
- our reported results may be affected adversely by the implementation of new, or changes in the interpretation of existing, accounting principles or financial reporting requirements, which could require us to incur substantial additional expenses; and
- compliance with changing regulation of corporate governance and public disclosure will result in additional expenses to us and pose challenges for our management.

Given these uncertainties, readers are cautioned not to place undue reliance on the forward-looking statements. We disclaim 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.

PART I

ITEM 1. BUSINESS.

General

Key Technology was founded in 1948 as a local producer of vegetable processing equipment. We have evolved into a worldwide supplier of process automation solutions to the food processing industry and other industries such as tobacco and pharmaceuticals. We were incorporated in 1982 as a result of a management buyout of our predecessor organization.

We and our 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 that include specialized conveying and preparation equipment. We provide parts and service for each of our product lines to customers throughout the world.

Net sales for the year ended September 30, 2013 were $136.8 million compared with $115.2 million for fiscal 2012 and $116.3 million for fiscal 2011. We reported net earnings for fiscal 2013 of $4.0 million, or $0.69 per diluted share, compared with net earnings of $0.4 million, or $0.08 per diluted share, for fiscal 2012 and a net earnings of $1.5 million, or $0.27 per diluted share, for fiscal 2011. Export and international sales for the fiscal years ended September 30, 2013, 2012 and 2011 accounted for 45%, 45% and 41% of net sales in each year, respectively. Total assets at September 30, 2013 were $114.6 million compared to $86.4 million at September 30, 2012 and $94.4 million at September 30, 2011.

Industry Background

Food Processing Industry

Our primary market is the food processing industry where we apply our processing knowledge and application expertise to help customers improve quality, increase yield, and reduce cost. Our integrated sorting, conveying, and process automation systems are sold to small, medium and large-sized food processing companies for a range of specialized applications. Food processors generally experience thin profit margins and, therefore, are focused on increasing profitability and efficiency in their processing plants by improving the performance of their equipment and processing lines. In addition, food processors recognize the value of new technology and continue to demand innovative equipment that addresses food safety, quality, and automation to drive productivity in their plants.

Our strategy is to offer equipment solutions that reduce reliance on manual inspection and address the common food processing industry problems associated with high labor costs, availability of labor, inadequate yields, and inconsistent product quality and food safety. In highly developed markets, including those in North America and Western Europe, the substitution of automated processes for manual labor is well underway. Food processors in these regions typically appreciate the value of replacing manual labor with automated systems and look for systems that will help maximize yields, product quality and food safety. In developing countries, interest in automation is rising as food processors in these regions increasingly strive to compete in a global economy by improving product quality and food safety.

Within the food processing industry, the greatest opportunities for automated inspection systems have been in potatoes, vegetables, and fruits where the frequency and severity of foreign material and defects is highly variable, depending on the countless factors that affect crops. In addition, dried fruit and tree nuts are high value products and processors increasingly demand inspection and automation to increase profitability. We believe that many additional applications for our automated inspection systems exist in other food processing markets and non-food markets.

The principal potato market served by our systems is potato strips (commonly referred to as french fries in the United States). Potato strips have historically accounted for a very large portion of the frozen potato products produced in the U.S. and, with the expansion of American-style fast food chains in other countries, this market is growing internationally. Investment in new potato strip processing facilities has increased slightly in comparison to historical levels, but demand remains strong in North America and Europe for new systems that improve yields and enhance product quality and food safety. Although we have successfully been diversifying into other food and non-food markets in recent years to reduce dependence on this market, potato strips remain an important market along with other potato products such as wedges, curly fries, formed products, whole potatoes and potato chips.

Other important markets within the food processing industry are fruits and vegetables, including both fresh-cut produce and processed products that may ultimately be canned or frozen for institutional and retail customers. Because foreign material and product defects plague these field-harvested products, automated sorting enhances the quality and safety of the product while improving yields and reducing labor costs. Our principal fruit and vegetable markets are fresh, frozen, canned and dehydrated green beans, corn, carrots, peas, onions, berries, cranberries, pears and peaches, as well as ready-to-eat fresh-cut salads.

As a result of the merger with Visys NV in early 2013, we are able to offer a suite of products that address the dried fruit and nut market. Nut processors strive to produce various products (shelled or unshelled) that are free of foreign material, extraneous vegetative matter or out-of-specification nuts to increase the value of their product. Numerous technologies and methodologies are applied at various steps in the processing line to further increase this value. The processor's quality objectives are achieved with our range of digital sorting systems and, when combined with our mechanical grading systems, create an integrated product package.

We believe that selected areas of the food processing industry will continue to present opportunities for growth. In general, food processing companies remain financially viable, but are increasingly coming under pressure to increase profitability and improve product safety while maintaining or reducing prices for their own products. By offering equipment that increases yields, enhances product quality and food safety, and results in reduced processing costs, we believe we are well positioned to satisfy the needs of the industry.

Seasonal fluctuations in the potato, fruit, and vegetable processing industries cause us to experience some predictable seasonality of orders and shipments. Typically, orders and shipments for this industry tend to be lower during our first two fiscal quarters of the year than during the second half of the fiscal year. Other, less seasonal markets that are served by the company include snack, bakery, dairy, poultry, and seafood products, as well as non-food markets.

Non-food Industries – Tobacco, Pharmaceuticals and Nutraceuticals

Processors, manufacturers and packagers in several non-food industries are interested in automated inspection systems that reduce costs, increase yields, and improve product quality and safety. Our primary non-food markets include the tobacco industry, pharmaceuticals and nutraceuticals.

The tobacco industry accounted for less than 5% of our net sales in fiscal 2013. With systems that remove non-tobacco related material from primary processing lines and threshing lines, we help tobacco processors maximize product quality. In 2009, we entered into an original equipment manufacturer distribution agreement with Hauni Maschinenbau AG, a leading supplier of equipment to the tobacco industry. The agreement gives Hauni exclusive rights to market our equipment to tobacco processors worldwide and makes Key Technology the sole supplier of optical sorting equipment to Hauni for the tobacco market.

In fiscal 2013, the pharmaceutical and nutraceutical industry, which is served by our pharmaceutical product line, SYMETIX®, also represented less than 5% of our net sales. SYMETIX's optical inspection systems for softgels and tablets remove defects and foreign capsules and tablets from the product stream. These systems are of interest to brand owners, product manufacturers, and contract packers looking to assure product quality while reducing labor costs.

We own a 15% minority interest in Proditec SAS. Proditec, headquartered in France, is a leading manufacturer of automated, solid dose pharmaceutical inspection systems based on machine vision technology. We and Proditec are promoting and selling inspection solutions in the pharmaceutical and nutraceutical markets.

Products

The following table sets forth sales by product category for the periods indicated (in thousands):

	Fiscal Year Ended September 30,								
	2013			2012			2011		
Automated inspection systems	$59,336	43	%	$46,586	40	%	$52,962	46	%
Process systems	50,729	37	%	44,939	39	%	40,716	35	%
Parts and service	26,718	20	%	23,649	21	%	22,650	19	%
Net sales	$136,783	100	%	$115,174	100	%	$116,328	100	%

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

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

	Fiscal Year Ended September 30,					
	2013		2012		2011	
Automated inspection systems	44	%	40	%	45	%
Process systems	28	%	28	%	27	%
Parts and service	28	%	32	%	28	%
Total gross margin	100	%	100	%	100	%

Automated Inspection Systems

Automated inspection systems are used in various applications to detect and remove defects and foreign material from the product stream and help processors improve quality and increase the value of their end product. Key offers a sophisticated range of digital sorting systems that recognize color, size, shape, structural properties, and chemical composition to detect the widest range of visible and invisible defects.

Depending on the needs of each application, our sorters can be designed with a combination of cameras and lasers to detect and remove a wide variety of defects and foreign material, which is an important contributor to food safety. When lasers are combined with high resolution cameras for superior shape, size, and color determination, the result is a high quality product. Advanced color and shape sorting can be accomplished with monochromatic or color cameras, coupled with powerful software algorithms. In addition, BioPrint™ technology, developed by Visys, identifies defects and foreign material based on unique biological characteristics and achieves enhanced performance, even under high incoming defect loads, and detects invisible defects.

Our popular belt-fed sorters - Optyx®, Tegra®, and Manta® - are primarily used in the fresh and frozen fruit, vegetable and potato products segments. Our chute-fed sorters, including the Visys Spyder®, Visys Python, and Visys Cayman®, and the jointly developed Taurys™, are ideal for sorting nuts, dried fruits, and frozen vegetables. Our other automated inspections systems include Veo™, an optical sorter designed specifically for seed corn; Tobacco Sorter™ tobacco sorting systems used in tobacco threshing and primary processing; and ADR® automatic defect removal systems used in the potato strip industry.

We also offer automated inspection equipment for solid dose pharmaceuticals and nutraceuticals through our SYMETIX pharmaceutical product line. Available in a range of sizes, VeriSym sorting systems inspect the color, size, and shape of tablets and softgels and automatically remove defects and foreign tablets or capsules from the product stream at rates of up to 1,000,000 tablets or capsules per hour. These inspection systems help product manufacturers and contract packers assure the quality of their finished product and are designed to replace batch processing systems historically used in this industry.

In July 2013, we signed an exclusive licensing agreement with EVK DI Kerschhaggl GmbH and Insort GmbH to deploy chemical imaging technology (CIT®) in our products, further enhancing our potato sorting capabilities. Additionally, an exclusive distribution agreement enables us to market Insort’s chemical imaging sorters to North American and global accounts in the potato industry.

We have a large installed base of automated inspection systems, which we support with upgrades to extend the life of the equipment and enable customers to continue operating at peak performance as technology advances. Upgrades often provide customers with a less capital intensive alternative to acquiring new automated inspection systems.

Process Systems

Conveying and processing equipment are utilized worldwide throughout many industries to move and process product within a production plant. The process systems group includes standard and custom designed equipment that conveys, dewaters, transfers, distributes, aligns, feeds, meters, separates, grades, blanches, cooks, pasteurizes, cools, cleans, washes, and polishes products. Our Smart Shaker® vibratory solutions, which include Iso-Flo®, Impulse®, and Horizon™ systems, combine gentle material handling with a wide variety of processing functions in addition to vibratory conveying. Rotary sizing and grading systems, Turbo-Flo® steam blanchers and SYMETIX equipment for pharmaceuticals and nutraceuticals, complete our conveying and processing equipment product line.

The mechanical sizing, sorting, separating, and grading equipment manufactured at the Company’s Redmond, Oregon facility is used in many food processing and fresh vegetable packing operations. These rotary sizing and grading technologies can remove oversized, undersized, and small irregular-shaped pieces of product from the line or separate product into predetermined size categories. Additionally, this equipment can remove field debris, broken pieces, seeds, juice, fines, and other targeted material.

Preparation Systems. We design and manufacture preparation systems to prepare a wide range of food products prior to cooking, freezing, canning, or other types of processing. Equipment in this group includes air cleaners, air coolers, vegetable metering and blending systems, and bulk handling equipment. This equipment represents our most mature product line. Sales of these solutions over the years have formed a customer base for sales of other of our solutions and are also establishing a new customer base in developing markets. Preparation system revenues include a variety of third-party supplied equipment and installation services, which are sold as components of larger, integrated processing lines, for which we have assumed turn-key sales responsibility. In addition, the process systems group includes other custom designed conveying and raw food sizing, grading, and preparation equipment. In 2010, the Company signed an agreement with ABCO Industries to sell their thermal processing equipment through our distribution channels.

Line Solutions

Integrated Solutions. Our Integrated Solutions Group (ISG) provides integrated whole-line solutions. From pre-engineering and project definition to plant start-up, ISG offers complete turn-key solutions that can include the integration of third-party products along with Key’s sorting, conveying, and processing systems to meet the specific needs of each application. We leverage our industry expertise and strong engineering and project management capabilities to deliver complete integration services, all from a single source.

Parts and Service

We have a large installed base of inspection and processing systems, which generates potential business for our parts, service, and training programs. Our PROliance™ suite of support services, parts, protection plans and training solutions, provides spare parts and post-sale field and telephone-based repair services to support our customers’ routine maintenance requirements, seasonal equipment startup and winterization processes. Our field service personnel are geographically located around the world in locations closest to customers enabling quick response time and regional technical support. We typically provide incidental system installation support services in the sale price of select systems, principally automated inspection systems.

RemoteMD™. RemoteMD is a real-time condition and monitoring and diagnostics analysis tool for G6 optical sorters - Manta, Optyx, and Tegra - as well as G6 ADR systems, RemoteMD proactively monitors the condition of the customer's system, assesses the status, and alerts the customer if problems are detected. By automating detection and diagnosis, RemoteMD provides detailed information to our service technicians, which increases the first-time fix-rate, reduces in-plant service calls, speeds resolution time and enhances customer productivity. We offer three distinct levels of RemoteMD services as part of our three comprehensive protection plans - SelectPRO, PlusPRO, and PremierPRO. Each of the three protection plans is sold via annual subscription.

Online Training. This program provides customers with an interactive multimedia curriculum covering selected optical inspection systems and vibratory conveyors. The flexible, web-based program offers a wide variety of self-paced training modules designed for operators, maintenance personnel, sanitation crews, supervisors, and others working with this equipment. Our Online Training Program includes modules that cover ADR hardware, Optyx hardware, Tegra hardware, G6 software, Iso-Flo vibratory conveyors, and a variety of industry compliance topics.

Research and Development

At September 30, 2013, our research and development department had 65 employees who conduct new product research and development and sustaining engineering for released products. Our technical staff includes electronic, optical, mechanical and software engineers, mathematicians and technical support personnel.

In fiscal 2013, our research and development expenses were approximately $9.6 million, compared to $8.3 million in fiscal 2012 and $6.9 million in fiscal 2011.

Manufacturing

We maintain manufacturing facilities in Walla Walla, Washington; Redmond, Oregon; Beusichem, The Netherlands; and Hasselt, Belgium. Our current manufacturing facilities and our product design and manufacturing processes integrate Computer Aided Engineering (CAE), Finite Element Analysis (FEA), Computer Aided Design (CAD), Computer Aided Manufacturing (CAM) and Computer Integrated Manufacturing (CIM) technologies. Manufacturing activities include process engineering; fabrication, welding, finishing and assembly of custom designed stainless steel systems; camera and electronics assembly; subsystem assembly; and system test and integration. The following table provides a summary of our manufacturing locations and manufacturing floor space:

Location	Manufacturing Facility	Products/Services Produced
Walla Walla, Washington	132,000 square feet	Automated Inspection Systems Process Systems Parts and Service
Redmond, Oregon	17,000 square feet	Process Systems Parts and Service
Beusichem, The Netherlands	37,000 square feet	Process Systems Automated Inspection Systems Parts and Service
Hasselt, Belgium	13,000 square feet	Automated Inspection Systems Parts and Service

We manufacture certain products to Underwriters Laboratories and United States Department of Agriculture standards. Certain of our products also comply with the Canadian Standards Association (CSA), European CE (Conformité Européene) and Electronic Testing Laboratory (ETL) safety standards. Certain products for the pharmaceutical/nutraceutical industry are FDA 21 CFR 11-compliant and designed using GAMP4 guidelines. Our domestic facilities were recertified to the ISO 9001:2008 standard in 2011.

Certain components and subassemblies included in our products are obtained from limited-source or sole-source suppliers. We attempt to ensure that adequate supplies are available to maintain manufacturing schedules. We may also use contract or third-party manufacturers to fulfill customer needs for ancillary products or equipment that we do not manufacture. We do not have long-term contracts with any of our suppliers. We also rely on third-party domestic and foreign suppliers for certain raw materials. Several of these suppliers are the single source of the raw material. We may be adversely affected in the event that these suppliers cease operations or if pricing terms become less favorable.

Sales and Marketing

We market our equipment worldwide both directly and through independent sales representatives. Sales by independent sales representatives generally account for between 20% and 30% of our consolidated net sales. In the United States, we operate sales offices in Walla Walla, Washington and Redmond, Oregon. Our international sales offices are: Key Technology B.V. and Visys N.V., which provide sales and service to European, Middle Eastern, Indian, and African customers; Key Technology Australia Pty Ltd., which provide sales and service to customers primarily in Australia and New Zealand; and Productos Key Mexicana S. de R.L. de C.V., which provides sales and service to customers in Mexico, and Central and South America. We supply equipment from both product groups - automated inspection systems and process systems - to customers in our primary markets through common sales and distribution channels. In addition, we supply parts and service through our worldwide service organization.

Sales of most exports of products manufactured in the United States for shipment into international markets, other than Europe, have been denominated in U.S. dollars. Sales of products manufactured in Europe are typically denominated in Euros. As we expand our operations in Australia and Latin America, transactions denominated in the local currencies of these countries may increase. In connection with our export and international sales, we are 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 or decrease the sales prices in local currencies of our products in international markets; tariffs and other barriers and restrictions; and the requirements of complying with a variety of international laws. Additional information regarding domestic and international sales is set forth in Note 17 to the Company's Consolidated Financial Statements for the fiscal year ended September 30, 2013.

During fiscal 2013, 2012 and 2011, sales to McCain Foods Limited represented approximately 11%, 10%, and 11% of total net sales, respectively. During fiscal 2013, sales to ConAgra Foods, Inc. represented 11% of total net sales. While we believe that our relationship with these customers is satisfactory, the loss of either of these customers could have a material adverse effect on our revenues and results of operations. Each of these customers represents a group of plants under common control. Generally, purchasing decisions for these customers are made at the individual plant level which may diversify the concentration of risk.

Backlog

Our backlog as of September 30, 2013 and September 30, 2012 was approximately $25.2 million and $30.8 million, respectively. We schedule production based on firm customer commitments and forecasted requirements. We include in backlog only those customer orders for which we have accepted purchase orders, or the equivalent.

Competition

The markets for automated inspection systems and process systems are highly competitive. We experience severe price competition across almost all our product lines. Other important competitive factors include performance, reliability, and customer support and service. We believe that we currently compete 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 our competitors may have substantially greater financial, technical, marketing and other resources. Other companies which sell products in certain of our markets include Heat & Control, Inc. and its subsidiaries; Tomra Systems ASA and its subsidiaries, BEST N.V. and Odenberg Inc.; Sortex Ltd.; Kiremko B.V.; Meyer Industries, Inc.; KMG Systems Ltd.; VDL Industrial Products B.V.; TNA Australia Pty. Ltd.; and BMA AG. We have encountered additional smaller competitors entering our markets, including the introduction of potentially competing tobacco sorters into the Chinese market manufactured by Chinese companies. As we enter new markets, we expect to encounter additional new competitors.

Patents and Trademarks

We currently hold 32 United States patents on various features of our products issued from 1994 through fiscal 2013, and 15 other national patents issued by other countries. The first of these patents will expire in fiscal 2014. Although we consider our patents to be important to our business, we believe these expirations will not have a significant effect on us. Of the numbers above, five patents were issued in fiscal 2013. As of December 6, 2013, 15 United States patent applications and 37 other foreign national patent applications were pending. We have 59 registered trademarks and six pending application for trademarks.

We also attempt to protect our 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 our products are or may be manufactured or sold may not protect our products and intellectual property rights to the same extent as the laws of the United States.

Employees

At September 30, 2013, we had 602 full-time employees, including 346 in manufacturing and project engineering, 65 in research and development, 143 in marketing, sales and service, and 48 in general administration and finance. A total of 178 employees are located outside the United States. We also utilize temporary contract employees, which improves our ability to adjust manpower in response to changing demand for our products. Of the total number of employees at September 30, 2013, 11 were contract employees. None of our employees in the United States are represented by a labor union. The employees located at our facility in Beusichem, The Netherlands are represented by the Small Metal Union. We have never experienced a work stoppage, slowdown or strike.

7

Available Information

Our annual and quarterly reports and other filings with the United States Securities and Exchange Commission ("SEC") are made available free of charge through the Investor Relations section of our website at www.key.net as soon as reasonably practicable after we file such material with the SEC. The information on or that can be accessed through our website is not a part of this Annual Report on Form 10-K.

ITEM 1A. RISK FACTORS.

In addition to the other information in this Annual Report on Form 10-K, the following risk factors should be considered carefully in evaluating our business because such factors may have a significant effect on our operating results and financial condition. As a result of the risk factors set forth below and the information presented elsewhere in this Annual Report on Form 10-K, actual results could differ materially from those included in any forward-looking statements.

Adverse changes in general economic conditions and disruption in financial markets may adversely affect the business of our customers and our business and results of operations.

Our business may be affected by uncertainties and general economic conditions beyond our control that may cause customers to defer or cancel new orders and sales commitments previously made. Uncertainty about the direction and relative strength of the economy in the United States and other important markets may be sufficient reason for customers to delay, defer or cancel purchase decisions, including decisions previously made. Economic difficulties in the United States and certain international markets could cause a decrease in the overall demand for our products.

Deterioration of national and global economic conditions and disruptions in credit and other financial markets could, among other things:

- adversely affect our expansion plans, including possible acquisitions;
- impair the financial condition of some of our customers and suppliers, thereby increasing customer bad debts or non-performance by suppliers;
- adversely affect our ability to fund new product development necessary to meet future customer requirements;
- negatively affect global demand for our customers' products, particularly in the food industry, which could result in underutilization of our production facilities and a reduction of sales, operating income and cash flows;
- negatively affect our customers' ability to obtain financing, which could result in a reduction in sales, operating income and cash flows;
- negatively affect our return on cash and cash equivalents;
- make it more difficult or costly for us to obtain financing for our operations or investments;
- negatively affect the results of our risk management activities if we are required to record losses related to financial instruments or experience counterparty failure;
- require asset write-downs; or
- impair the financial viability of our insurers.

The ongoing uncertainty and volatility in the global financial markets may adversely affect our operating results.

Our operations and performance depend on worldwide economic conditions. Global financial markets continue to experience disruptions, including increased volatility and diminished liquidity and credit availability. In particular, we may be affected by the continuing uncertainties associated with the debt crisis in certain countries in the European Union and the austerity measures being implemented or contemplated by various countries in Europe. If global economic and market conditions, or economic and financial market conditions in Europe, the United States or other key markets, remain uncertain, persist, or deteriorate further, our customers may respond by suspending, delaying or reducing their capital expenditures, which may adversely affect our cash flows and results of operations. Furthermore, our customers may experience increased difficulty in obtaining credit to finance purchases of the Company's products. In addition, these conditions may affect the ability of our suppliers to provide goods and materials to us on a consistent and timely basis which may adversely affect our operations.

Discord, conflict, and lack of compromise within and between the executive and legislative branches of the U.S. government related to federal government budgeting, taxation policies, government expenditures, and U.S. borrowing/debt ceiling limits could adversely affect our business and operating results.

The inability of the legislative and executive branches of the U.S. government to pass in a timely manner a federal government budget, control deficit spending, address tax revenue requirements and effectively manage short and long term U.S. government borrowing, debt ratings, and debt ceiling adjustments could negatively affect U.S. domestic and global financial markets reducing demand by our customers for our products and services. Similarly, if our suppliers face challenges in obtaining credit, in selling their products, or otherwise in operating their businesses, they may become unable to continue to offer the materials we purchase from them to manufacture our products. The uncertainty resulting from these conflicts could result in reductions in our revenues, increased price competition, or increased operating costs, which could adversely affect our results of operations and financial condition.

Adverse economic conditions in the food processing industry, either globally or regionally, may adversely affect our revenues.

The markets we serve, particularly in the food processing industry, are generally experiencing variable economic conditions. Additionally, varying consumer demand due to economic conditions or dietary trends, product supply, and excess plant capacity, most notably in the potato market, could result in reduced or deferred capital equipment purchases for our product lines. While we have reacted to these developments with applications directed toward the growing fresh vegetable and fruit industries as well as the pharmaceutical and nutraceutical industries, loss of business, particularly in the potato industry, would have a negative effect on our sales and net earnings.

The loss of any of our significant customers could reduce our revenues and profitability.

We have significant, strategic customers and we anticipate that our operating results may continue to depend on these customers for the foreseeable future. The loss of any one of those customers, or a significant decrease in the volume of products they purchase from us, could adversely affect our revenues and materially adversely affect our profitability. Any difficulty in collecting outstanding amounts due from one of those customers may also harm our operating results. In addition, sales to any particular large customer may fluctuate significantly from quarter to quarter causing fluctuations in our quarterly operating results.

Significant investments in unsuccessful research and development efforts could materially adversely affect our business.

The product solutions we offer are very complex, and we need to successfully develop new products in a global competitive environment. If we fail to accurately predict and meet future customer needs and preferences, fail to incorporate critical industry-leading technologies and solutions in our products, or fail to allocate our research and development funding to products with higher customer acceptance and growth prospects, we may find we have invested heavily in the development of products that do not lead to significant revenue. Failure to successfully develop new products may also cause existing or potential customers to choose competitors' products. Any of such events may reduce future revenues and adversely affect our competitive position. Even if we successfully innovate and develop new products and product enhancements, we may incur substantial costs in doing so, and our profitability may be reduced.

Industry consolidation could increase competition in the food processing equipment industry.

The food processing equipment industry has experienced recent consolidation. Consolidation by our competitors may enhance their production capacity, technological abilities, broaden their product lines and resources, and lower their cost structure and prices, causing us to be at a competitive disadvantage. Increased competition and our ability to respond effectively to any of these changing market conditions could result in significant price erosion, reduced revenue, lower margins, and loss of market share, any of which could adversely affect our net earnings.

We are subject to price competition that may reduce our profitability.

We face price sensitivity from customers as well as aggressive pricing by our competitors, particularly in periods of excess capacity. Recent consolidation among our primary competitors may also allow these competitors to compete more effectively on price. These conditions may require us to lower prices in order to be price-competitive. In addition, because of their purchasing volume, our larger customers can influence market participants to compete on price terms. Such customers also use their buying power to negotiate lower prices. Customers are also increasing the use of integrated supply chain sourcing solutions focused solely on immediate cost savings. If we are not able to offset resulting price reductions by improving operating efficiencies and reducing expenses, such price reductions may have an adverse effect on our profit margins and net earnings.

The significance of major orders could result in significant fluctuation in quarterly operating results.

The timing of our significant orders depends on a number of factors over which we may have little or no control, including the size and complexity of a potential transaction, the level of competition that we encounter in our selling activities and our current and potential customers' internal budgeting and approval process. As a result, we may expend significant effort over a long period of time in an attempt to obtain an order, but ultimately not obtain the order, or the order ultimately received may be smaller than anticipated. Our orders from different customers vary from quarter to quarter, and a customer with a large order in one quarter may generate significantly lower orders in subsequent quarters. Due to resulting fluctuations, we believe that quarter-to-quarter comparisons of our revenue and operating results may not be meaningful, and that these comparisons may not be an accurate indicator of our future performance.

The failure of our independent sales representatives to perform as expected would harm our net sales.

Sales by independent sales representatives generally account for between 20% and 30% of our consolidated net sales. If our independent sales representatives fail to market, promote and sell our products adequately, our business will be adversely affected. Our independent sales representatives could reduce or discontinue sales of our products, sell competitors product lines, or they may not devote adequate resources to selling our products in the volumes and within the time frames that we expect, either of which events could adversely affect our revenues and net earnings.

We have made, or may make, acquisitions or enter into distribution agreements or similar business relationships that could disrupt our operations and harm our operating results.

We have made, or may in the future make, acquisitions of businesses, or enter into distribution agreements or similar business relationships that offer products, services, or technologies that we believe would complement our business. These changes in our business present significant challenges and risks and there can be no assurances that we will manage these changes successfully. These changes in our business involve numerous risks, including:

- significant potential expenditures of cash, stock, and management resources;
- difficulty achieving the potential financial and strategic benefits of the acquisition or business relationship;
- difficulties in integrating acquired operations or products, including the potential loss of key employees from the acquired business;
- difficulties of integrating different technologies into products and markets due to technological challenges;
- assumption of product liabilities, including warranty costs, for third party products;
- increased costs due to required minimum purchase levels and commitments for payments to third parties;
- difficulties and costs associated with evaluating and integrating the information systems and internal control systems of the acquired business;
- impairment of assets related to goodwill and other intangible assets resulting from an acquisition, and reduction in our future operating results from amortization of intangible assets;
- diversion of management's attention from our core business, including loss of management focus on marketplace development;
- potential difficulties in complying with foreign regulatory requirements;
- adverse effects on existing business relationships with suppliers and customers, including the potential loss of suppliers and customers of the acquired business;
- assumption of liabilities, known and unknown, related to the acquired business in general, and litigation and other legal process involving the acquired business in particular, including intellectual property litigation risk;
- entering geographic areas or distribution channels in which we have limited or no prior experience; and
- those risks related to general economic and political conditions.

There can be no assurance that attractive acquisition opportunities will be available to us, that we will be able to obtain financing for or otherwise consummate any acquisition, or that any acquisition that we do consummate will be successful.

Our international operations subject us to a number of risks that could adversely affect our revenues, operating results and growth.

We conduct business outside the United States, which subjects us to the risks inherent in international operations. In fiscal 2013, our international sales represented approximately 45% of our consolidated net sales, compared to approximately 45% of our consolidated net sales in fiscal 2012. Risks inherent in international operations include the following:

- unexpected changes in regulatory and certification requirements;
- restrictive governmental actions (such as restrictions on the transfer or repatriation of funds and trade protection measures, including export duties and quotas, customs duties and tariffs, or trade barriers erected by either the United States or other countries where we do business);
- currency restrictions and exchange rate fluctuations;
- scrutiny of foreign tax authorities which could result in significant fines, penalties and additional taxes;
- changes in import or export licensing requirements;
- longer payment cycles;
- transportation delays;
- competitive pricing that we may experience internationally;
- challenges in implementing cost effective operating and manufacturing strategies in varied geographic regions;
- economic downturns, civil disturbances or political instability;

- geopolitical turmoil, including terrorism or war;
- difficulties and costs of staffing and managing geographically disparate operations;
- changes in labor standards;
- laws and business practices favoring local companies;
- limitations on our ability under local law to protect our intellectual property;
- changes in domestic and foreign tax rates and laws; and
- difficulty in obtaining sales representatives and servicing products in foreign countries, which may adversely affect sales in those countries.

The occurrence of any of the above risks could adversely affect our revenues, operating results and growth.

Fluctuations in foreign currency exchange rates could result in unanticipated losses that could adversely affect our liquidity and results of operations.

We are exposed to foreign currency exchange rate fluctuations because a portion of our revenues, expenses, assets and liabilities are denominated in foreign currencies. Changes in foreign currency exchange rates affect our results of operations and financial position. We attempt to manage certain effects of foreign currency fluctuations by entering into short-term forward exchange contracts in situations where it is both possible and practical. In these instances, these contracts are designed to minimize specific foreign currency gains or losses, as the gains or losses on the derivative are intended to offset the losses or gains on the underlying exposure. However, these contracts do not cover our full exposure and, additionally, there is no guarantee that these forward contracts will protect against the foreign exchange fluctuations in the underlying exposure. Accordingly, we could experience foreign currency gains or losses that could have a material impact on our operating results.

Advances in technology by competitors may adversely affect our sales and profitability.

The rapidly changing needs of the markets for our products demand constant innovation. Competitors may be able to adapt or develop technologies to create or enhance product offerings that directly compete with our products. Advances in technology may also remove some barriers to market entry, enabling additional competitors to enter our markets. These innovations could cause our products to become less competitive or obsolete, and decrease our sales and profits, having a material adverse effect on our business and financial condition. There can be no assurance that we will be able to continue to develop new products to compete effectively in the future.

Our existing and new products may not compete successfully in either current or new markets, which would adversely affect our sales and operating results.

Our future success and growth is dependent upon our ability to develop, manufacture, market, and sell products and services in certain food processing markets as well as to introduce new products into other existing and potential markets. There can be no assurance we can successfully and profitably penetrate these potential markets or expand into new international markets with our current or future products. There are inherent risks in developing new technologies, entering new markets, and in our existing markets including:

- length of time and cost for development of these technologies and markets;
- development of the technological capability to address the requirements and performance specifications of new and existing markets;
- our ability to manufacture our products in various geographies, which may affect our success in certain emerging markets;
- our ability to design products for ease of manufacturability and service;
-

- product reliability issues related to both new technology and adapting existing products to operate in new or rugged operating environments at customer sites; and
- failure to meet performance specifications, which could damage the profitability and the reputation of the Company and its products.

Our expansion into new markets, increasingly complex projects and applications, and integrated product offerings could increase our cost of operations and reduce gross margins and profitability.

Our growth strategy includes expansion into new product and geographic markets, complex projects and applications, and integrated product offerings to provide turnkey solutions to customers. As a result, we may encounter new types of competition and be required to develop new sales channels. Development of such markets and turnkey solutions is likely to require sustained investment, increase our cost of sales, reduce our gross margins to the extent products purchased from others are integrated into our product offerings, and result in overall reduced profitability. We are also likely to encounter technical challenges and increased costs related to the integration of products from multiple vendors, adaptation and installation of products in larger and more complex plants, ensuring product performance in more difficult operating environments, and meeting unfamiliar customer requirements and performance specifications. Despite rigorous testing and quality processes, newly-developed or enhanced products or solutions may encounter challenges during or after their initial introduction or installation. We may also encounter increased warranty costs, performance issues and liability risks from products we sell but do not manufacture.

Our inability to obtain products and components from suppliers would adversely affect our ability to manufacture and market our products.

In certain instances, we depend on original equipment manufacturers and other suppliers of components included in our products for the timely delivery of our integrated turnkey products. Such suppliers may experience problems beyond our control, which may disrupt our ability to deliver our products to our customers and damage our relationships with current and future customers. These risks may include varying lead times, supplier capacity, delayed shipments, and quality control problems. In addition, supplier pricing may change and be higher than anticipated. As a result of these and other factors, our revenues and profit margins may be adversely affected.

Our information systems, computer equipment and information databases are critical to our business operations and any damage or disruptions could adversely affect our business and results of operations.

Our operations are dependent on our ability to protect our information systems, computer equipment and information databases from systems failures. Such failures could be caused by internal or external events, such as incursions by intruders or hackers, computer viruses, failures in hardware or software, power fluctuations or cyber terrorists. The failure of these systems to perform as anticipated for any reason or any significant breach of security could disrupt our business and result in numerous adverse consequences, including reduced effectiveness and efficiency of operations, increased overhead costs and loss of important information, which could have a material adverse effect on our business and results of operations.

Our potential inability to retain and recruit experienced management and other key personnel, or the loss of key management personnel, may adversely affect our business and prospects for growth.

Our success depends in part on the skills and experience of our employees. The loss of services of such employees could adversely affect our business until suitable replacements can be found. In addition, our headquarters are located in Walla Walla, Washington, a small, relatively remote geographic location. As such, there may be a limited number of individuals locally with the requisite skill and experience, and we have from time-to-time experienced difficulty recruiting individuals from larger metropolitan areas.

Consequently, we may not be able to retain and recruit a sufficient number of qualified individuals on acceptable terms to maintain our business or achieve planned growth. Our success also depends, to a significant degree, upon the continued individual and collective contributions of our management team. A limited number of individuals have primary responsibility for managing our business, including our relationships with key customers. These individuals are integral to our success based on their expertise and knowledge of our business and products. The loss of the services of members of the management team and other key employees for any reason could have a material adverse effect on our business.

The potential inability to protect our intellectual property, especially as we expand geographically, may adversely affect our competitive advantage.

Our competitive position may be affected by our ability to protect our proprietary technology. We have obtained certain patents and have filed a number of patent applications. We also anticipate filing applications for protection of our future products and technology. There can be no assurance that any such patents will provide meaningful protection for our product innovations, or that the issuance of a patent will give us any material advantage over our competition in connection with any of our products. We may experience additional intellectual property risks in international markets where we may lack patent protection or experience challenges to our intellectual property. The patent laws of other countries, such as China, may differ from those of the U.S. as to the patentability of our products and processes. Moreover, the degree of protection afforded by foreign patents may be different from that of U.S. patents.

Intellectual property-related litigation expenses and other costs resulting from infringement claims asserted against us by third parties may adversely affect our results of operations and our customer relations.

The technologies used by us may infringe the patents or proprietary technology of others, and we have been required in the past to initiate litigation to protect our patents. There is also a trend toward aggressive, strategic enforcement of intellectual property rights. As a result, there is a risk that we would be subject to infringement claims which, regardless of validity, could:

- be expensive, time consuming and divert management attention away from normal business operations;
- require us to pay monetary damages or enter into non-standard royalty and licensing agreements;
- require us to modify our product sales and development plans; or
- require us to satisfy indemnification obligations to our customers.

Regardless of whether these claims have any merit, they can be burdensome to defend or settle and can harm our business and reputation.

Our subsidiary Visys N.V. is involved in ongoing litigation that may result in an adverse outcome. Regardless of the outcome, we will be forced to expend resources as a participant in the litigation.

Our subsidiary Visys N.V. ("Visys") is subject to certain litigation due to patent infringement and other claims made by Belgian Electronics Sorting Technologies NV (“BEST”). BEST has filed several complaints since 2006 in various Belgian courts against Visys, which we acquired on February 28, 2013. Although we believe that BEST’s claims against Visys are without merit, an unfavorable decision in any litigation involving BEST could have a material adverse effect on our profitability and financial condition. We believe that the likelihood of an outcome that materially and adversely affects us is remote, but the litigation could ultimately require us to make a financial payment to BEST, or enter into license agreements with BEST. There is no guarantee that we would be able to make such payments without adversely affecting operations, or obtain license agreements with BEST on commercially reasonable terms. In the event of an unfavorable outcome, we are also entitled to receive indemnification payments under certain circumstances from the former shareholders of Visys pursuant to the acquisition agreement, but there can be no assurance that such payments would be adequate to cover all potential damages. Finally, regardless of the outcomes of the BEST proceedings, Visys may be forced to expend significant resources defending itself, potentially affecting our profitability and financial condition. The ultimate resolution of the matters involving BEST, and the associated financial effect on us, remains uncertain.

Our dependence on certain suppliers may leave us temporarily without adequate access to raw materials or products.

We also rely on third-party domestic and foreign suppliers for certain raw materials. Several of these suppliers are the single source of the raw material. We do not have long-term contracts with any supplier. We may be adversely affected in the event that these suppliers cease operations or if pricing terms become less favorable. The loss of a key vendor may force us to purchase our necessary raw materials and components in the open market, which may not be possible or may be at higher prices, until we could secure another source. There is no assurance that the terms of any subsequent supply arrangements we may enter into would be as favorable as the supply arrangements we currently have in place. If we are unable to replace a key supplier, we may face delays in delivering finished products, which could have an adverse effect on our sales, financial performance and reputation.

Our operating results are seasonal and may further fluctuate due to severe weather conditions affecting the agricultural industry in various parts of the world.

A large portion of our customer base processes agricultural products and its demand for our products and solutions fluctuates seasonally. Consequently, we generally experience lower sales and net income in our first two fiscal quarters. As a result of these seasonal and quarterly fluctuations, comparisons of our sales and operating results between different quarters within a single fiscal year may not necessarily provide meaningful comparisons.

In addition, in the event of severe weather conditions or geological events that negatively affect the production of growers, such as prolonged droughts, serious floods or earthquakes, the food processing industry may not invest in a particular year or years in new equipment in the affected locations. As a result, our revenues, results of operations and cash flows could be materially adversely affected.

The limited availability and possible cost fluctuations of materials used in our products could adversely affect our gross margins.

Certain basic materials, such as stainless steel, are used extensively in our product fabrication processes. Such basic materials have, in the past, been subject to worldwide shortages or price fluctuations related to the supply of or demand for raw materials, such as nickel, which are used in their production by our suppliers. A significant increase in the price or decrease in the availability of one or more of these components, subassemblies or basic materials could adversely affect our results of operations.

Compliance with recently passed health care legislation and increases in the cost of providing health care plans to our employees may adversely affect our business.

In March 2010, Congress passed the Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act (collectively, the "Acts"). Among other things, the Acts contain provisions that will affect employer-sponsored health care plans, impose excise taxes on certain plans, and reduce the tax benefits available to employers that receive the Medicare Part D subsidy. Nationally, the cost of providing health care plans to a company's employees has increased at annual rates in excess of inflation. There continues to be uncertainty whether the Acts will increase the cost of employee health plan coverage. Continued significant annual increases in the cost of providing employee health coverage may adversely affect our business and results of operations.

Our reported results may be affected adversely by the implementation of new, or changes in the interpretation of existing, accounting principles or financial reporting requirements, which could require us to incur substantial additional expenses.

Our financial reporting complies with the Generally Accepted Accounting Principles (“GAAP”) in the United States, and GAAP is subject to change over time. If new rules or interpretations of existing rules require us to change our financial reporting (including the adoption of international financial reporting standards in the United States), our reported results of operations and financial condition could be affected substantially by the new requirements, which could include requirements to restate historical financial statements. Our management team may need to devote significant time and financial resources to comply with evolving standards, which may lead to increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

Compliance with changing regulation of corporate governance and public disclosure will result in additional expenses to us and pose challenges for our management.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Dodd-Frank Wall Street Reform and Consumer Protection Act and the rules and regulations promulgated under that act, the Sarbanes-Oxley Act and SEC regulations, have created uncertainty for public companies and significantly increased the costs and risks associated with accessing the U.S. public markets. Our management team will need to devote significant time and our financial resources to comply with both existing and evolving standards for public companies, which will lead to increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

15

ITEM 2. PROPERTIES

We own or lease 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	173,000	Owned	n/a	n/a
Walla Walla, Washington	Customer Visitor Center, equipment demonstration facility	31,500	Leased	2015	Two five-year renewal periods
Redmond, Oregon	Manufacturing, research and development, sales, administration	19,000	Leased	2022	Two five-year renewal periods
Beusichem, The Netherlands	Manufacturing, sales and marketing, administration	45,000	Leased	2015	One year
Beusichem, The Netherlands	Warehouse	11,000	Leased	2015	One year
Hasselt, Belgium	Manufacturing, sales and marketing, research and development, administration	19,500	Leased	2016	Three years

We also have leased office space for sales and service and other activities in Walla Walla, Washington; Sacramento, California; Dingley, Australia; Querétaro, Mexico; and Rotselaar and Hasselt, Belgium.

We consider all of our properties suitable for the purposes for which they are used.

ITEM 3. LEGAL PROCEEDINGS.

On January 27, 2006, Belgian Electronics Sorting Technologies NV ("BEST") filed a complaint in the Court of First Instance in Antwerp, Belgium against our subsidiary Visys, acquired on February 28, 2013, alleging infringement of BEST's patent on a sorting apparatus with a laser detection system. BEST seeks injunctive relief, and damages and costs aggregating approximately €12,750,000. Visys has introduced certain counterclaims and commenced related proceedings in the Netherlands alleging the invalidity of the principal patent in question. In October 2012, the invalidity claim was partially granted by the Dutch court. Oral argument is now scheduled in the Belgian proceeding for February 2014, with a possible decision expected later in 2014.

In addition, on August 17, 2007, BEST started entitlement proceedings in the Court of First Instance in Antwerp related to two patents of Visys which Visys does not currently use. This case is set for trial before the Court of Appeal of Antwerp in April 2014. On June 29, 2011, BEST commenced nearly identical entitlement proceedings in the Commercial Court of Antwerp regarding a U.S. patent of Visys that is part of the same patent family as is at issue in the entitlement proceeding set for trial in the Court of Appeal. The judge in the Commercial Court has stayed these proceedings until the decision of the Court of Appeal.

Lastly, on April 30, 2008, BEST initiated proceedings against Visys for trademark infringement and unfair competition, which proceedings have been dismissed by the Court of Appeal of Antwerp. The Belgian Supreme Court confirmed this decision, except for two claims related to unfair trade practices concerning use of meta tags and a domain name. These issues were appealed and argued before the European Court of Justice in January 2013. The European Court of Justice decided the two technical legal issues before it in July 2013 and remanded the case back to the Belgian Supreme Court for further proceedings. We currently believe the financial consequences of the remaining claims are not material.

As a result of our due diligence investigation in connection with the acquisition of Visys, we believe BEST's claims against Visys are without merit, and Visys intends to pursue its defenses in these proceedings.

From time-to-time, the Company is named as a defendant in other legal proceedings arising out of the normal course of its business.

ITEM 4. MINE SAFETY DISCLOSURE.

Not Applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Market Information

Shares of our common stock are quoted on The NASDAQ Global Market under the symbol “KTEC”. The following table shows the high and low sales prices per share of our common stock, as reported on NASDAQ, by quarter for the two most recent fiscal years ending September 30, 2013:

Stock price by quarter	High	Low
Fiscal year ended September 30, 2013		
First Quarter	$10.71	$8.19
Second Quarter	$13.09	$10.14
Third Quarter	$16.40	$12.35
Fourth Quarter	$15.50	$12.21
Fiscal year ended September 30, 2012		
First Quarter	$15.30	$10.65
Second Quarter	$15.34	$12.45
Third Quarter	$13.97	$9.49
Fourth Quarter	$10.88	$7.51

We had approximately 1,476 beneficial owners of its common stock, of which 135 are of record, as of December 6, 2013.

We have not historically paid dividends on our common stock. The board of directors presently intends to continue its policy of retaining earnings for reinvestment in our operations.

Issuer Purchases of Equity Securities

The following table provides information about purchases made by us or on our behalf during the quarter ended September 30, 2013 of equity securities registered by us under Section 12 of the Securities Exchange Act of 1934.

Period	Total Number of Shares Purchased[1]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
July 1-31, 2013	810	$15.18	—	
August 1-31, 2013	—	—	—	
September 1-30, 2013	796	$13.80	—	
Total	1,606	$14.50	—	429,202[2]

(1) Includes shares of restricted stock surrendered to satisfy tax withholding obligations by plan participants under our employee stock incentive plans. The shares were subsequently canceled.

(2) We initiated a new stock repurchase program effective May 30, 2012. We were authorized to purchase up to 500,000 shares of our common stock under the program. The timing of any repurchases and the exact number of shares of common stock to be purchased will be determined by us and will depend on market conditions and other factors. The program does not incorporate a fixed expiration date.

STOCK PERFORMANCE GRAPH

COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN
AMONG KEY TECHNOLOGY, INC., THE RUSSELL MICROCAP INDEX, AND PEER GROUP

	2008	2009	2010	2011	2012	2013
Key Technology, Inc.	100.00	47.47	54.51	47.66	40.83	58.20
Russell Microcap Index	100.00	92.06	98.91	94.13	128.26	169.46
Peer Group	100.00	80.06	83.30	83.19	84.67	130.99

PEER GROUP: Cognex Corporation, Perceptron, Inc., Flir Systems, Inc., John Bean Technologies Corporation, Tomra Systems, Inc., Isra Vision AG.

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, 2013 has been derived from our audited consolidated financial statements. The information below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements and the Notes thereto as provided in Item 7 and Item 8, respectively, of this Annual Report on Form 10-K.

		Fiscal Year Ended September 30,				
		2013	2012	2011	2010	2009
		(in thousands, except per share data)				
Statement of Operations Data:						
Net sales		$136,783	$115,174	$116,328	$115,804	$105,450
Cost of sales		90,739	79,339	78,531	75,651	66,427
Gross profit		46,044	35,835	37,797	40,153	39,023
Operating expenses		40,213	34,867	35,310	34,896	39,609
Gain (loss) on disposition of assets		42	(15)	4	77	(352)
Income (loss) from operations		5,873	953	2,491	5,334	(938)
Other income (expense)		(460)	(359)	(542)	(172)	(431)
Earnings (loss) from continuing operations before income taxes		5,413	594	1,949	5,162	(1,369)
Income tax (benefit) expense		1,402	145	495	1,524	(878)
Net earnings (loss)		$4,011	$449	$1,454	$3,638	$(491)
Earnings (loss) per share	– basic	$0.69	$0.08	$0.27	$0.69	$(0.10)
	– diluted	$0.69	$0.08	$0.27	$0.69	$(0.10)
Cash dividends per share		$—	$—	$—	$—	$—
Shares used in per share calculation	– basic	5,836	5,390	5,311	5,277	5,116
	– diluted	5,855	5,399	5,329	5,293	5,116
Balance Sheet Data:						
Cash and cash equivalents and short-term investments		$17,601	$23,755	$28,754	$29,096	$18,142
Working capital		42,338	44,136	42,484	41,475	37,033
Property, plant and equipment, net.		17,259	18,370	19,433	16,821	16,175
Total assets		114,624	86,354	94,405	91,267	80,715
Current portion of long-term debt		871	364	345	333	319
Long-term debt, less current portion		5,612	4,833	5,197	5,542	5,876
Shareholders' equity		73,125	59,430	58,774	56,338	51,457

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

Introduction

We and our wholly-owned subsidiaries design, manufacture and sell process automation systems integrating electro-optical inspection, sorting and process systems.

We own five subsidiaries: Key Technology Holdings USA LLC; Key Technology Australia Pty Ltd.; Productos Key Mexicana S. de R. L. de C.V.; Key Technology (Shanghai) Trading Co., Ltd.; and Key Technology Asia-Pacific Pte. Ltd. Key Technology Holdings USA LLC owns Visys N.V. and Suplusco Holding B.V., its European subsidiary, which owns Key Technology B.V. We manufacture products in Walla Walla, Washington; Redmond, Oregon; Beusichem, The Netherlands, and Hasselt, Belgium.

Overview

Sales increased $21.6 million, or 18.8%, to $136.8 million for the year ended September 30, 2013 compared with $115.2 million for fiscal 2012, while orders increased $18.0 million, or 16.5%, in fiscal 2013 over fiscal 2012. We reported net earnings for fiscal 2013 of $4.0 million, or $0.69 per diluted share, compared with net earnings of $449,000, or $0.08 per diluted share, for fiscal 2012. Net earnings increased in fiscal 2013 compared to fiscal 2012 as a result of a $10.2 million increase in gross profit, offset by higher operating expenses of $40.2 million, or 29.4% of net sales, compared to $34.9 million, or 30.3% of net sales, for fiscal 2012. The increase in gross margins to 33.7% in fiscal 2013 from 31.1% in fiscal 2012 was due to a higher mix of higher margin automated system sales and the product mix within automated inspection systems, and more efficient factory utilization, partially offset by higher warranty and customer support costs due in part to the increase in net sales and $1.0 million of acquisition related fair value adjustments to acquired inventory. Operating expenses increased $5.3 million, or 15.3%, in fiscal 2013 as compared to fiscal 2012 due to the acquisition of Visys, the results of which have been included since the acquisition date, February 28, 2013, higher commissions due to the increase in net sales; increased research and development expenses related to developing new technology solutions; and the increased expenses associated with amortization of intangible assets. Other expenses were $460,000 in fiscal year 2013 compared to $359,000 in fiscal year 2012.

Automated inspection systems sales increased 27%, process systems sales were up 13%, and parts and service sales increased 13% in fiscal 2013 compared to the prior fiscal year. Orders for automated inspection systems increased 48%, process system orders decreased 7%, and parts and service orders increased 15% in fiscal 2013 compared to the prior fiscal year. Export and international sales for the fiscal years ended September 30, 2013, 2012 and 2011 accounted for 45%, 45% and 41% of net sales in each year, respectively.

While the Company produced significantly improved operating results in fiscal 2013, our major business still serves seasonal and cyclical industries, and it remains typical for order and backlog quantities to vary on a quarter-by-quarter basis. While we have recently seen a softening in the European region, we remain positive regarding our overall international opportunities.

Our acquisition of Visys, completed on February 28, 2013, was a critical component of our long-term strategy. Visys has brought new technology, expertise and chute-fed solutions that complement our existing product portfolio. The Visys products have enabled us to add nuts and dried fruit as a new core market as well as expand our available product offerings and solutions in the processed fruit and vegetables and potato markets. The Visys team, now fully integrated within Key, adds capabilities and skill sets that augment our already talented and experienced team.

In fiscal 2013, we focused on our five strategic imperatives, which will continue in fiscal 2014. Those five strategic imperatives are as follows:

1. Developing and introducing new technology-leading platforms and solutions;
2. Increasing global market share in our core markets through new products, focused regional sales strategies, and leveraging our integrated solutions capability;
3. Expanding into new high-potential market adjacencies by leveraging new product platforms;
4. Continuing to strengthen and develop internal capabilities and third-party partnerships necessary for industry-leading solutions; and
5. Further strengthening a winning culture within Key Technology, driving our "innovation architecture."

Acquisition

Effective February 28, 2013, we completed the acquisition of Visys NV ("Visys"), a Belgian supplier of high-end digital sensor-based optical sorters. We acquired 100% of the outstanding shares of Visys for approximately $21.3 million, consisting of $13.2 million in cash, 600,000 shares of our common stock and warrants to purchase 250,000 shares of our common stock. Visys has been included in our operating results for the period from the date of acquisition. Further information regarding the acquisition of Visys is contained in Footnote 2 to our Consolidated Financial Statements as of September 30, 2013.

License and Distribution Agreements

In July 2013, we entered into an exclusive license agreement with EVK Di Kerschhaggl GmbH and Insort GmbH to deploy chemical imaging technology for potato processing applications and to integrate new hyperspectral developments into our automated inspection systems, and an exclusive distribution agreement to market Insort's complementary sorting solutions exclusively in North America and to strategic specified customers worldwide. These partnerships are expected to enhance our ability to offer high-performance digital sorting technologies in the potato industry, and facilitate our development of next-generation hyperspectral sorters for a variety of food processing applications.

Application of Critical Accounting Policies

We have identified our critical accounting policies, the application of which may materially affect our financial statements, either because of the significance of the financial statement item to which they relate, or because they require management judgment to make estimates and assumptions in measuring, at a specific point in time, events which will be settled in the future. The critical accounting policies, judgments and estimates which management believes have the most significant effect on the financial statements are set forth below:

- Revenue recognition
- Allowances for doubtful accounts
- Valuation of inventories
- Long-lived assets
- Allowances for warranties
- Accounting for income taxes

Management has discussed the development, selection and related disclosures of these critical accounting estimates with the audit committee of our board of directors.

Revenue Recognition. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the sale price is fixed or determinable, and collectability is reasonably assured. Additionally, we sell our goods on terms which transfer title and risk of loss at a specified location, typically shipping point, port of loading or port of discharge, depending on the final destination of the goods. Accordingly, revenue recognition from product sales occurs when all criteria are met, including transfer of title and risk of loss, which occurs either upon shipment by us or upon receipt by customers at the location specified in the terms of sale. Sales of system upgrades are recognized as revenue upon completion of the conversion of the customer’s existing system when this conversion occurs at the customer site. Certain other, less frequent, equipment sales are recognized as revenue upon completion of installation at the customer site. Revenue earned from services (maintenance, installation support, and repairs) is recognized ratably over the contractual period or as the services are performed. If any contract provides for both equipment and services (multiple deliverables), the sales price is allocated to the various elements based on the relative selling price. Each element is then evaluated for revenue recognition based on the previously described criteria. We typically have a very limited number of contracts with multiple deliverables and they are not material to the financial statements. Our sales arrangements provide for no other significant post-shipment obligations. If all conditions of revenue recognition are not met, we defer revenue recognition. In the event of revenue deferral, the sale value is not recorded as revenue to us, accounts receivable are reduced by any related amounts owed by the customer, and the cost of the goods or services deferred is carried in inventory. In addition, we periodically evaluate whether an allowance for sales returns is necessary. Historically, we have experienced few sales returns. We account for cash consideration (such as sales incentives) that are given to customers or resellers as a reduction of revenue rather than as an operating expense unless an identified benefit is received for which fair value can be reasonably estimated. We believe that revenue recognition is a “critical accounting estimate” because our terms of sale vary significantly, and management exercises judgment in determining whether to recognize or defer revenue based on those terms. Such judgments may materially affect net sales for any period. Management exercises judgment within the parameters of accounting principles generally accepted in the United States of America (GAAP) in determining when contractual obligations are met, title and risk of loss are transferred, the sales price is fixed or determinable and collectability is reasonably assured. At

September 30, 2013, we had invoiced $4.0 million, compared to $2.4 million at September 30, 2012, for which we have not recognized revenue.

Allowances for doubtful accounts. We have established allowances for doubtful accounts for specifically identified, as well as anticipated, doubtful accounts based on credit profiles of customers, current economic trends, contractual terms and conditions, and customers' historical payment patterns. Factors that affect collectability of receivables include general economic or political factors in certain countries that affect the ability of customers to meet current obligations. We actively manage our credit risk by utilizing an independent credit rating and reporting service, by requiring certain percentages of down payments, and by requiring secured forms of payment for customers with uncertain credit profiles or located in certain countries. Forms of secured payment could include irrevocable letters of credit, bank guarantees, third-party leasing arrangements or EX-IM Bank guarantees, each utilizing Uniform Commercial Code filings, or the like, with governmental entities where possible. We believe that the accounting estimate related to allowances for doubtful accounts is a "critical accounting estimate" because it requires management judgment in making assumptions relative to customer or general economic factors that are outside our control. As of September 30, 2013, the balance sheet included allowances for doubtful accounts of $296,000 as compared to $190,000 at September 30, 2012. Amounts charged to bad debt expense for fiscal 2013 and 2012 were $2,000 and $24,000, respectively. Actual charges to the allowance for doubtful accounts for fiscal 2013 and 2012 were $26,000 and $84,000, respectively. If we experience actual bad debt expense in excess of estimates, or if estimates are adversely adjusted in future periods, the carrying value of accounts receivable would decrease and charges for bad debts would increase, resulting in decreased net earnings.

Valuation of inventories. Inventories are stated at the lower of cost or market. Our inventory includes purchased raw materials, manufactured components, purchased components, service and repair parts, work in process, finished goods and demonstration equipment. Write downs for excess and obsolete inventories are made after periodic evaluation of historical sales, current economic trends, forecasted sales, estimated product lifecycles and estimated inventory levels. The factors that contribute to inventory valuation risks are our purchasing practices, electronic component obsolescence, accuracy of sales and production forecasts, introduction of new products, product lifecycles and the associated product support. We actively manage our exposure to inventory valuation risks by maintaining low safety stocks and minimum purchase lots, utilizing just in time purchasing practices, managing product end-of-life issues brought on by aging components or new product introductions, and by utilizing inventory minimization strategies such as vendor-managed inventories. We believe that the accounting estimate related to valuation of inventories is a "critical accounting estimate" because it is susceptible to changes from period-to-period due to the requirement for management to make estimates relative to each of the underlying factors ranging from purchasing to sales to production to after-sale support. At September 30, 2013, cumulative inventory adjustments to lower of cost or market totaled $3.5 million compared to $2.6 million as of September 30, 2012. Amounts charged to expense to record inventory at lower of cost or market for fiscal 2013 and 2012 were $1.7 million and $1.6 million, respectively. Actual charges to the cumulative inventory adjustments upon disposition or sale of inventory were $867,000 and $826,000 for fiscal 2013 and 2012, respectively. If actual demand, market conditions or product lifecycles are adversely different from those estimated by management, inventory adjustments to lower market values would result in a reduction to the carrying value of inventory, an increase in inventory write-offs, and a decrease to gross margins.

Long-lived assets. We regularly review all of our long-lived assets, including property, plant and equipment, and amortizable intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If the total of projected future undiscounted cash flows is less than the carrying amount of these assets, an impairment loss based on the excess of the carrying amount over the fair value of the assets is recorded. In addition, goodwill is reviewed based on its fair value at least annually. As of September 30, 2013, we held $40.1 million of long-lived assets, net of depreciation and amortization. There were no material changes in our long-lived assets that would result in an adjustment of the carrying value for these assets. Estimates of future cash flows arising from the utilization of these long-lived assets and estimated useful lives associated with the assets are critical to the assessment of recoverability and fair values. We believe that the accounting estimate related to long-lived assets is a “critical accounting estimate” because: (1) it is susceptible to change from period-to-period due to the requirement for management to make assumptions about future sales and cost of sales generated throughout the lives of several product lines over extended periods of time, future results of operations, and market multiples used in valuation models; and (2) the potential effect that recognizing an impairment could have on the assets reported on our balance sheet and the potential material adverse effect on reported earnings or loss. Changes in these estimates could result in a determination of asset impairment, which would result in a reduction to the carrying value and a reduction to net earnings in the affected period.

Allowances for warranties. Our products are covered by standard warranty plans included in the price of the products ranging from 90 days to five years, depending upon the product and contractual terms of sale. The majority of the warranty periods are for one year or less. We establish allowances for warranties for specifically identified, as well as anticipated, warranty claims based on contractual terms, product conditions and actual warranty experience by product line. Our products include both manufactured and purchased components and, therefore, warranty plans include third-party sourced parts which may not be covered by the third-party manufacturer’s warranty. We actively manage our quality program by using a structured product introduction plan, process monitoring techniques utilizing statistical process controls, vendor quality metrics, and feedback loops to communicate warranty claims to designers and engineers for remediation in future production. We believe that the accounting estimate related to allowances for warranties is a “critical accounting estimate” because: (1) it is susceptible to significant fluctuation period-to-period due to the requirement for management to make assumptions about future warranty claims relative to potential unknown issues arising in both existing and new products, which assumptions are derived from historical trends of known or resolved issues; and (2) risks associated with third-party supplied components being manufactured using processes that we do not control. As of September 30, 2013, the balance sheet included warranty reserves of $2.7 million, while $4.2 million of warranty charges were incurred during the fiscal year then ended, compared to warranty reserves of $2.0 million as of September 30, 2012 and warranty charges of $3.6 million for the fiscal year then ended. If our actual warranty costs are higher than estimates, future warranty plan coverages are different, or estimates are adversely adjusted in future periods, reserves for warranty expense would need to increase, warranty expense would increase and gross margins would decrease.

Accounting for income taxes. Our provision for income taxes and the determination of the resulting deferred tax assets and liabilities involves a significant amount of management judgment. The quarterly provision for income taxes is based partially upon estimates of pre-tax financial accounting income for the full year and is affected by various differences between financial accounting income and taxable income. Judgment is also applied in determining whether the deferred tax assets will be realized in full or in part. In management’s judgment, when it is more likely than not that all or some portion of specific deferred tax assets will not be realized, a valuation allowance must be established for the amount of the deferred tax assets that are determined not to be realizable. At September 30, 2013, we had valuation reserves of approximately $180,000 for deferred tax assets for capital loss carryforwards and changes in the carrying value of our investment in Proditec, and offsetting amounts for foreign deferred tax assets and U.S. deferred tax liabilities, primarily related to net operating loss carry forwards in the foreign jurisdictions that we believe will not be utilized during the carryforward periods. During fiscal 2013, we recorded net additional valuation reserves of $2,000 related to capital loss carryforwards and $3,000 as part of the acquisition of Visys related to net operating loss carryforwards. In addition, we reversed offsetting amounts of approximately $135,000 of valuation reserves for foreign deferred tax assets and U.S. deferred tax liabilities related to the utilization of net operating loss carryforwards in Europe in fiscal 2013. As these were offsetting amounts, these changes had no effect on net earnings. During fiscal 2012, we recorded net additional valuation reserves of $5,000 related to capital loss carryforwards. In addition, we recorded offsetting amounts of approximately $2.5 million of valuation reserves for foreign deferred tax assets and U.S. deferred tax liabilities related to net operating loss carryforwards in foreign jurisdictions that we believe will not be utilized during the carryforward periods. We also reversed offsetting amounts of approximately $700,000 of valuation reserves for Chinese deferred tax assets and U.S. deferred tax liabilities related to net operating loss carry forwards that were utilized in the foreign jurisdiction. As these were all offsetting amounts, these changes had no effect on net earnings. During fiscal 2011, we recorded $160,000 of valuation reserves related to net operating loss carryforwards in foreign jurisdictions offset by U.S. deferred tax liabilities and reversed $17,000 of valuation reserves for capital loss carryforwards that were utilized to offset capital gains on our corporate income tax return. There were no other valuation allowances at September 30, 2013 due to anticipated utilization of all the deferred tax assets as we believe we will have sufficient taxable income to utilize these assets. We maintain reserves for estimated tax exposures in jurisdictions of operation. These tax jurisdictions include federal, state and various international tax jurisdictions. Potential income tax exposures include potential challenges of various tax credits and deductions, and issues specific to state and local tax jurisdictions. Exposures are typically settled primarily through audits within these tax jurisdictions, but can also be affected by changes in applicable tax law or other factors, which could cause our management to believe a revision of past estimates is appropriate. At September 30, 2013, we had reserves of $126,000 for estimated tax exposures. During fiscal 2013 and 2012, there were no significant changes in these estimates. Management believes that an appropriate liability has been established for estimated exposures; however, actual results may differ materially from these estimates. We believe that the accounting estimate related to income taxes is a “critical accounting estimate” because it relies on significant management judgment in making assumptions relative to temporary and permanent timing differences of tax effects, estimates of future earnings, prospective application of changing tax laws in multiple jurisdictions, and the resulting ability to utilize tax assets at those future dates. If our operating results were to fall short of expectations, thereby affecting the likelihood of realizing the deferred tax assets, judgment would have to be applied to determine the amount of the valuation allowance required to be included in the financial statements in any given period. Establishing or increasing a valuation allowance would reduce the carrying value of the deferred tax asset, increase tax expense and reduce net earnings.

In fiscal 2013, the existing research and development tax credit was retroactively renewed and extended to December 31, 2013. Due to this change in tax law, the Company recorded approximately $192,000 of additional research and development credits in fiscal 2013 related to research and development expenditures incurred during fiscal 2012. The research and development credit was effective for the Company for only the first fiscal quarter of 2012 prior to its expiration date. Similarly, in fiscal 2011, an additional $72,000 of research and development credits were recorded which related to R&D expenditures in fiscal 2010.   The research and development credit expires December 31, 2013 and, as of the date of this report, has not been renewed.

Comparison of Fiscal 2013 to Fiscal 2012

	Fiscal Year Ended September 30,			
	2013	2012	Change $	Change %
	(in thousands)			
Statement of Operations Data				
Net sales	$136,783	$115,174	$21,609	18.8
Gross profit	46,044	35,835	10,209	28.5
Operating Expenses:				
Sales and marketing	18,976	17,439	1,537	8.8
Research and development	9,647	8,343	1,304	15.6
General and administrative	10,594	9,070	1,524	16.8
Amortization	996	15	981	N/M*
Total operating expense	40,213	34,867	5,346	15.3
Gain (loss) on disposition of assets	42	(15)	57	N/M*
Income from operations	5,873	953	4,920	516.3
Other income (expense)	(460)	(359)	(101)	28.1
Income tax expense	1,402	145	1,257	866.9
Net earnings	$4,011	$449	3,562	793.3
Balance Sheet Data				
Cash and cash equivalents	$17,601	$23,755	(6,154)	(25.9)
Accounts receivable	17,725	11,426	6,299	55.1
Inventories	27,921	23,166	4,755	20.5
Other Data (unaudited)				
Orders for year ended September 30	126,930	108,976	17,954	16.5
Backlog at fiscal year end	25,231	30,810	(5,579)	(18.1)

* Not Meaningful

Results of Operations

Fiscal 2013 compared to Fiscal 2012

Net sales for the year ended September 30, 2013 were $136.8 million, a 19% increase from the $115.2 million reported for fiscal 2012. International sales for fiscal 2013 were 45% of net sales and 45% in the corresponding prior year period. The increase in net sales occurred most significantly in North America and Europe, partially offset by decreases in net sales in Latin America. Sales in our automated inspection systems product line increased by 27% to $59.3 million in fiscal 2013, accounting for 43% of total revenues, compared to $46.6 million in fiscal 2012, or 40% of total revenues. The increase in automated inspection system sales was principally in the potato market, as well as other food markets, offset by decreases in the processed fruit and vegetable and fresh cut markets. The increase in automated inspection system sales occurred in the ADR, Tegra, VEO, Verisym and upgrade product lines, partially offset by decreases in Optyx, Raptor, Manta and tobacco sorter product lines. Process systems sales in fiscal 2013 were $50.7 million a 13% increase from the $44.9 million reported for fiscal 2012. Sales of process systems accounted for 37% of total revenues in fiscal 2013 compared to 39% in fiscal 2012. The increase in process systems sales related primarily to vibratory products in Europe and other process system equipment, partially offset by a decrease in rotary sizing and grading systems and third-party equipment. Parts and service sales increased from the prior year by $3.1 million or 13% to $26.7 million compared to $23.6 million in fiscal 2012. Parts and service sales represented 20% of sales in fiscal 2013 and 21% in fiscal 2012.

Orders increased 16%, or $17.9 million, to $126.9 million in fiscal 2013 from the $109.0 million of new orders received in fiscal 2012. Backlog at September 30, 2013 decreased 18% to $25.2 million compared to the $30.8

million reported at the end of fiscal 2012. The order mix for the more recent year changed from fiscal 2012. For fiscal 2013, our higher margin automated inspection systems orders increased by $18.0 million, or 48%, representing 44% of order volume in fiscal 2013 compared to 34% in the prior year. This increase occurred in almost all automated product inspection lines, except for Optyx and ADR systems. Automated inspection system orders increased in fiscal 2013 across most major markets, and most significantly in the potato market, and principally in the North American region. Orders for process systems decreased by $3.4 million, or 7%, and

25

represented 35% of order volume in fiscal 2013 compared to 44% in the prior year. The decrease in orders for process systems occurred primarily in vibratory, rotary sizers and graders, and third-party equipment product lines, partially offset by increases in vibratory products in Europe and other process system equipment. Parts and service orders increased from the prior year by $3.4 million, or 15%, and represented 21% and 22% of orders in fiscal 2013 and fiscal 2012, respectively. Orders increased most significantly in the North American region, particularly in the potato market.

Automated inspection systems backlog was $14.2 million at the end of fiscal 2013, essentially the same as a year ago. The backlog for automatic inspection systems increased in the Manta, Tegra, tobacco sorter and Visys product lines offset by decreases in the ADR, Optyx and Raptor product lines. Backlog for process systems was down $6.0 million, or 39%, to $9.3 million at the end of fiscal 2013 compared to $15.3 million at the same time a year ago. The decrease in the backlog for process systems was primarily driven by a decrease in vibratory products, third-party equipment, and vibratory equipment in Europe. Backlog by product line at September 30, 2013 was 56% automated inspection systems, 37% process systems, and 7% parts and service, compared to 46% automated inspection systems, 50% process systems, and 4% parts and service at September 30, 2012.

Gross profit increased to $46.0 million for fiscal 2013 compared to $35.8 million in fiscal 2012, or 33.7% and 31.1% of net sales, respectively. The principal reasons for the increase in the gross profit margin percentage were a higher mix of higher margin automated inspection system sales and the product mix within automated inspection systems and more efficient factory utilization, partially offset by higher warranty and customer support costs due in part to the increase in net sales and $1.0 million of acquisition related fair market value adjustments to acquired inventory. Gross margins are expected to be significantly lower in the first quarter of fiscal 2014 as compared to the first quarter of fiscal 2013, and gross margin percentages for the first quarter of fiscal 2014 are expected to be adversely affected by unfavorable plant utilization.

Research and development expense increased $1.3 million to $9.6 million, or 7.1% of sales, in fiscal 2013 from $8.3 million, or 7.2% of sales, in fiscal 2012. In fiscal 2013, there was an increase in expenses related to developing new technology solutions, as well as the inclusion of the research and development expense of Visys since the acquisition date.

Sales and marketing expense in fiscal 2013 increased to $19.0 million compared to $17.4 million spent in fiscal 2012. As a percentage of sales, sales expense decreased to 13.9% of sales in fiscal 2013 from 15.1% of sales in fiscal 2012. The primary reasons for the sales and marketing expense increase in spending were increased net sales, higher commissions due to the increase in net sales, the inclusion of the sales and marketing expenses of Visys since the acquisition date, and increased sales incentive compensation.

General and administrative expense in fiscal 2013 was $10.6 million or 7.7% of sales for the year, compared to $9.1 million or 7.9% of sales for fiscal 2012. The primary reason for the increase in spending were the inclusion of Visys since the acquisition date, $785,000 of acquisition related expenses, and incentive compensation expenses.

Operating expenses for the first quarter of fiscal 2014 are anticipated to decrease modestly as compared to the fourth quarter of fiscal 2013.

Other income and expense was an expense of $460,000 for fiscal 2013 compared to $359,000 of expense for fiscal 2012. In fiscal 2013, we recognized foreign exchange losses of $146,000, net of the effects of forward contracts settled during the year, compared with exchange gains of $183,000 in fiscal 2012. In fiscal 2012, we recorded $209,000 of expense related to accumulated foreign currency translation adjustments reclassified from other comprehensive income to the results of operations.

The effective tax rate for the Company was a tax expense rate of 25.9% in fiscal 2013 compared to a tax expense rate of 24.4% in fiscal 2012. The effective tax rate in fiscal 2013 was favorably affected by the domestic production deduction and the research and development tax credit offset by other permanent deductions. The effective tax rate for fiscal 2013 was affected by the research and development credits recorded in fiscal 2013, including $192,000 of additional research and development tax credits related to fiscal 2012 recorded in fiscal 2013 due to changes in tax law during fiscal 2013 to retroactively renew the research and development tax credit. The ratios were also affected by the relative size of individual items compared to net earnings for fiscal 2013, which was significantly higher than net earnings in fiscal 2012.

Net earnings in fiscal 2013 were $4.0 million, or $0.69 per diluted share, compared to net earnings of $0.4 million, or $0.08 per diluted share, in fiscal 2012. The principal reasons for the increase in earnings for fiscal 2013 compared to fiscal 2012 were higher net sales and gross profit margins, partially offset by higher operating expenses. As a result of our lower fourth quarter ending backlog and anticipated shipment schedule, the Company expects that the results of operations will be significantly lower in the first quarter of fiscal 2014 than in the first quarter of fiscal 2013.

Fiscal 2012 compared to Fiscal 2011

Net sales for the year ended September 30, 2012 were $115.2 million, a 1.0% decrease from the $116.3 million reported for fiscal 2011. International sales for fiscal 2012 were 45% of net sales compared to 43% in the corresponding prior year period. The decrease in net sales in North America and Europe was partially offset by increases in net sales in Latin America and the Asia Pacific regions. Sales in our automated inspection systems product line decreased by 12% to $46.6 million in fiscal 2012, accounting for 40% of total revenues, compared to $53.0 million in fiscal 2011, or 46% of total revenues. The decrease in automated inspection system sales was due to a slow period for new capital investments, particularly in the potato market, as well as the effects of product competition. The decrease in automated inspection system sales was across most major product lines with the exception of the recently released VEO system and Manta product lines. Process systems sales in fiscal 2012 were $44.9 million, a 10% increase from the $40.7 million reported for fiscal 2011. Sales of process systems accounted for 39% of total revenues in fiscal 2012 compared to 35% in fiscal 2011. The increase in process systems sales related primarily to vibratory products, rotary sizing and grading systems and third-party equipment, partially offset by a decrease in vibratory product sales in Europe. Parts and service sales increased from the prior year by $1 million or 4% to $23.6 million, compared to $22.7 million in fiscal 2011. Parts and service sales represented 21% of sales in fiscal 2012 and 19% in fiscal 2011.

Orders decreased 7%, or $7.9 million, to $109.0 million in fiscal 2012 from the $116.8 million of new orders received in fiscal 2011. Backlog at September 30, 2012 decreased 15% to $30.8 million compared to the $36.2 million reported at the end of fiscal 2011. The order mix for the more recent year changed from fiscal 2011. For fiscal 2012, our higher margin automated inspection systems orders decreased by $14.0 million, or 27%, representing 34% of order volume in fiscal 2012 compared to 44% in the prior year. This decrease occurred in almost all automated product inspection lines, except for VEO and ADR systems. Automated inspection system orders decreased in fiscal 2012 in the processed fruit and vegetable market as fiscal 2011 included the final year of a significant three year contract with a major North American processor as well as due to the effects of product competition. Orders for process systems increased by $5.3 million, or 13%, representing 44% of order volume in fiscal 2012 compared to 36% in the prior year. The increase in orders for process systems occurred primarily in vibratory, rotary sizers and graders, and third-party equipment product lines offset by decreases in most other product lines. Parts and service orders increased from the prior year by $835,000, or 4%, and represented 22% and 20% of orders in fiscal 2012 and fiscal 2011, respectively. Orders increased in Europe and Latin America offset by decreases in North America and the Asia-Pacific region. Order increases in the potato market were offset by decreases in processed fruit and vegetable, fresh cut and other industries. Automated inspection systems backlog decreased by $8.8 million, or 38%, to $14.2 million at the end of fiscal 2012 compared to $23.0 million at the same time a year ago. The backlog decrease for automatic inspection systems was across almost all product lines. Backlog for process systems was up $3.2 million, or 27%, to $15.3 million at the end of fiscal 2012 compared to $12.1 million at the same time a year ago. The increase in the backlog for process systems was primarily driven by an increase in vibratory products, rotary sizers and graders, and vibratory equipment in Europe, partially offset by a decrease in fresh cut products. Backlog by product line at September 30, 2012 was 46% automated inspection systems, 50% process systems, and 4% parts and service, compared to 64% automated inspection systems, 33% process systems, and 3% parts and service at September 30, 2011.

Gross profit decreased to $35.8 million for fiscal 2012 compared to $37.8 million in fiscal 2011, or 31.1% and 32.5% of net sales, respectively. The principal reasons for the $2.0 million decrease in gross profit were a higher mix of lower margin process system sales and the product mix within automated inspection systems, continued price competition, partially offset by lower warranty and customer support costs and the effect of cost reduction initiatives. Our growth strategy related to integrated product offerings may reduce the gross margin percentages in future periods to the extent products purchased from others are integrated into our product offerings.

Research and development expense increased $1.4 million to $8.3 million, or 7.2% of sales, in fiscal 2012 from $6.9 million, or 6.0% of sales, in fiscal 2011. In fiscal 2012, there was an increase in expenses related to strategic initiatives for developing new technology solutions for the marketplace.

Sales and marketing expense in fiscal 2012 decreased to $17.4 million compared to $19.5 million spent in fiscal 2011. As a percentage of sales, sales expense decreased to 15.1% of sales in fiscal 2012 from 16.7% of sales in fiscal 2011. The primary reasons for the decrease in spending were lower internal sales and marketing personnel related costs due to cost reduction initiatives, decreased trade show and promotional costs, and lower commissions due to the decrease in net sales.

General and administrative expense in fiscal 2012 was $9.1 million and 7.9% of sales for the year, compared to $8.9 million and 7.6% of sales for fiscal 2011. The primary reason for the increase in spending was higher expenses associated with severance and other separation charges partially offset by lower personnel costs due to cost reduction initiatives.

Other income and expense was an expense of $359,000 for fiscal 2012 compared to $542,000 of expense for fiscal 2011. In fiscal 2012, we recognized foreign exchange gains of $183,000, net of the effects of forward contracts settled during the year, compared with exchange losses of $82,000 in fiscal 2011. We recorded $209,000 of expense related to accumulated foreign currency translation adjustments reclassified from other comprehensive income to the results of operations. Other expenses were also partially offset by $51,000 in royalty income received in fiscal 2012 and lower bank charges incurred in fiscal 2012.

The effective tax rate for the Company was a tax expense rate of 24.4% in fiscal 2012 compared to a tax expense rate of 25.4% in fiscal 2011. The effective tax rate in fiscal 2012 was favorably affected by the domestic production deduction and the R&D tax credit offset by other permanent deductions such as the limitation on meals and entertainment deductions. The ratios were also affected by the relative size of individual items compared to net earnings for fiscal 2012, which was significantly lower than net earnings in fiscal 2011. The effective tax rate for fiscal 2011 was primarily affected by the research and development credits recorded in fiscal 2011, including $72,000 of additional R&D tax credits related to fiscal 2010 recorded in fiscal 2011 due to changes in tax law during fiscal 2011 to retroactively renew the R&D tax credit.

Net earnings in fiscal 2012 were $449,000, or $0.08 per diluted share, compared to net earnings of $1.5 million, or $0.27 per diluted share, in fiscal 2011. The principal reasons for the decrease in earnings for fiscal 2012 compared to fiscal 2011 were lower net sales and gross profit margins, increased research and development expenses, partially offset by lower sales expenses and favorable changes in the components of other income and expense.

Liquidity and Capital Resources

Fiscal 2013

For fiscal 2013, net cash decreased by $6.2 million to $17.6 million on September 30, 2013 compared to $23.8 million on September 30, 2012. We generated $8.8 million in cash from operating activities, used $14.0 million in investing activities and consumed $1.0 million in financing activities.

The net cash provided by operating activities during fiscal 2013 of $8.8 million included net earnings for the year of $4.0 million, non-cash expenses for depreciation and amortization of $4.9 million, non-cash share-based payments of $1.3 million, offset by increases of $3.4 million in deferred taxes due to the timing of deductions for tax purposes. Non-cash working capital at September 30, 2013 decreased from the same time last year, providing $2.0 million of cash. The major changes in current assets and liabilities in fiscal 2013 that were sources of cash were a $3.7 million reduction of inventory due to lower backlog and inventory requirements, and a $3.7 million increase in accrued payroll liabilities due to the timing of payroll and timing of payments for increased commissions and increased sales and other incentive compensation, and a $0.9 million increase in customer support and warranty costs accrued due to the increase in net sales. These sources of cash were partially offset by increases in accounts receivable of $5.5 million due to the timing of shipments during the last fiscal quarter of 2013 and related timing of collections, decreases in customer deposits of $1.1 million related to the decreased backlog at fiscal year end, the timing of orders received in the last fiscal quarter of 2013 and related timing of customer down payments received. The changes in working capital in fiscal 2013 reflects normal variations in our operations.

Cash used in investing activities totaled $14.0 million during fiscal 2013, which primarily consisted of $13.2 million of cash used for the acquisition of Visys, net of cash of $1.6 million acquired in the transaction, and capital expenditures of $2.5 million. Capital expenditures were primarily for manufacturing equipment, leasehold improvements, and information systems software and equipment.

Cash used in financing activities totaled $1.0 million in fiscal 2013, which included payments on long-term debt of $697,000 associated with our mortgage on our headquarters facility, $240,000 for exchanges of shares for statutory tax withholding, and $30,000 of cash used for repurchases of our common stock, offset by $95,000 of proceeds from the issuance of common stock for option exercises and employee stock purchases.

Our domestic credit facility provides for a variable-rate revolving credit line of up to $15 million and a credit sub-facility of $6 million for standby letters of credit of which up to €3.0 million ($4.1 million) is available to our Netherlands facility. The credit facility matures on September 30, 2014. The credit facility bears interest, at our option, at either the bank's prime rate or the British Bankers Association LIBOR Rate ("BBA LIBOR") using a tiered structure depending upon our achievement of a specified financial ratio. Our prime rate option will be either the bank's prime rate or prime less 0.25% per annum. Our BBA LIBOR option will be either BBA LIBOR plus 1.75% or 1.50% per annum. At September 30, 2013, the interest rate would have been 1.68% based on the lowest of the available alternative rates. The credit facility is secured by all U.S. accounts receivable, inventory and equipment and fixtures. The loan agreement also provided for a 15-year term loan in the amount of $6.4 million of which $4.8 million was outstanding at September 30, 2013. The term loan provided for a mortgage on our Avery Street headquarters' land and building located in Walla Walla, Washington. The term loan bears interest at the BBA LIBOR rate plus 1.40% and matures on January 2, 2024. We have also simultaneously entered into an interest rate swap agreement with the lender to fix the interest rate at 4.27%. The credit facilities contain covenants which require operating within a funded debt to EBITDA ratio, a fixed charge coverage ratio and minimum working capital levels. The loan agreement permits capital expenditures up to a certain level, and contains customary default and acceleration provisions. The credit facilities also restrict acquisitions, incurrence of additional indebtedness and lease expenditures above certain levels without the prior consent of the lender. In fiscal 2013, the relevant loan agreement was amended to permit the acquisition of Visys. At September 30, 2013, we had no borrowings outstanding under the credit facility and $548.000 in standby letters of credit. At September 30, 2013, we were in compliance with our loan covenants. At September 30, 2012, we had no borrowings outstanding under the credit facility and $250,000 in standby letters of credit.

Our credit accommodation with a commercial bank in the Netherlands provides a credit facility for our European subsidiary. This credit accommodation totals €1.75 million ($2.4 million) and includes an operating line of the lesser of €250,000 ($338,000) or the available borrowing base, which is based on varying percentages of eligible accounts receivable and inventories, and a bank guarantee facility of €1.5 million ($2 million). The operating line and bank guarantee facility are secured by all of the subsidiary's personal property. The credit facility bears interest at the bank's prime rate, with a minimum of 3.00%, plus 1.75%. At September 30, 2013, the interest rate was 5.95%. The credit accommodation contains a covenant which requires the maintenance of minimum tangible net worth levels at the subsidiary. At September 30, 2013, we were in compliance with our loan covenants. At September 30, 2013, we had no borrowings under this facility and had received bank guarantees of €502,000 ($679,000) under the bank guarantee facility. The credit facility allows overages on the bank guarantee facility. Any overages reduce the available borrowings under the operating line. At September 30, 2012, we had no borrowings under this facility and had received bank guarantees of €152,000 ($196,000).

Our Belgian subsidiary's credit accommodation with a commercial bank in Belgium provides a credit facility for our Belgian subsidiary. This credit accommodation totals €2.7 million ($3.7 million) and includes an operating line of €800,000 ($1.1 million), a bank guarantee facility of €500,000 ($0.7 million), and loan agreement provisions of €1.4 million ($1.9 million). The operating line and bank guarantee facility are secured by all of the subsidiary's current assets. The Belgian operating line bears interest at the bank's prime rate, plus 1.25%. At September 30, 2013, the interest rate was 9.75%. At September 30, 2013, the subsidiary had no borrowings under the operating line. At September 30, 2013, the subsidiary had various loans outstanding under the loan agreement provision totaling €1.1 million ($1.5 million). The fixed interest rates on these loans ranged from 2.91% to 3.98%. The loans mature between February 2014 and November 2017. The credit accommodation contains a covenant which requires the maintenance of a minimum tangible net worth and debt to EBITDA ratio levels at the subsidiary measured as of December 31 of each fiscal year. At December 31, 2012, the subsidiary was in compliance with the tangible net worth covenant. At June 30, 2013, the subsidiary had no bank guarantees under the bank guarantee facility. Additionally, the subsidiary had a subordinated loan with another European lender of €130,000 ($176,000). The loan has a fixed interest rate of 4.99% and matures in March 2016.

We anticipate that current cash balances, ongoing cash flows from operations and borrowing capacity under currently available operating credit lines will be sufficient to fund our operating needs for the foreseeable future. Cash used for operating activities was $8.8 million in fiscal 2013, and cash provided by (used in) operating activities was $(1.3) million and $5.8 million in fiscal years 2012 and 2011, respectively. We had no material commitments for capital expenditures at September 30, 2013.

Prior Years - Fiscal 2012 and 2011

For fiscal 2012, net cash decreased by $5.0 million to $23.8 million on September 30, 2012 compared to September 30, 2011. We used $1.1 million in cash from operating activities, used $2.6 million in investing activities and consumed $1.3 million in financing activities.

The net cash used by operating activities during fiscal 2012 of $1.1 million included net earnings for the year of $449,000, non-cash expenses for depreciation and amortization of $3.7 million, non-cash share-based payments of $1.2 million, and increases of $73,000 in deferred taxes. Non-cash working capital at September 30, 2012 decreased from the same time last year, resulting in the use of $6.4 million of cash. The major changes in current assets and liabilities in fiscal 2012 were increases in accounts receivable of $2.7 million due to the timing of shipments during the last fiscal quarter of 2012 and related timing of collections, decreases in customer deposits of $5.5 million related to the decreased backlog at fiscal year end, the timing of orders received in the last fiscal quarter of 2012 and related timing of customer down payments received, and reductions in accounts payable of $706,000 due to reduced purchases as a result of the lower backlog and current inventory levels. These uses of cash were partially offset by a $887,000 reduction of inventory due to the lower backlog and inventory requirements, reductions of $880,000 of income taxes receivable related to net cash refunded during the period due to net operating loss carrybacks and $1.1 million reduction in prepaid expenses and other assets due to reduced vendor deposits and VAT receivables. The changes in working capital in fiscal 2012 reflects normal variations in our operations.

Cash used in investing activities totaled $2.6 million during fiscal 2012, which primarily consisted of capital expenditures of $2.6 million. Capital expenditures were primarily for manufacturing equipment and information systems software and equipment.

Cash used in financing activities totaled $1.3 million in fiscal 2012, which included payments on long-term debt of $345,000 associated with our mortgage on our headquarters facility, $205,000 for exchanges of shares for statutory tax withholding, and $710,000 of cash used for repurchases of our common stock, offset by $94,000 of proceeds from the issuance of common stock for option exercises and employee stock purchases.

For fiscal 2011, net cash decreased by $342,000, or 1%, to $28.8 million on September 30, 2011 compared to September 30, 2010. We provided $5.8 million in cash from operating activities, used $5.5 million in investing activities and consumed $588,000 in financing activities.

The net cash provided by operating activities during fiscal 2011 of $5.8 million included net earnings for the year of $1.5 million, non-cash expenses for depreciation and amortization of $2.9 million, non-cash share-based payments of $1.4 million, and increases of $1.7 million in deferred taxes. Non-cash working capital at September 30, 2011 increased from the same time last year, resulting in $1.5 million of cash used in operating activities. Decreases in trade receivables and accounts payable due to lower sales in the fourth quarter compared to the prior year, and increases in customer deposits due to a higher backlog and timing of customer payments and shipments, were offset by increases in inventory due to delayed customer shipments, increases in income tax receivables, and decreases in accrued payroll and other liabilities.

Cash used in investing activities totaled $5.5 million during fiscal 2011, which primarily consisted of capital expenditures of $5.6 million. Capital expenditures included costs associated with our new Innovation Center, corporate headquarters facility repairs, manufacturing equipment, and information systems software and equipment.

Cash used in financing activities totaled $588,000 in fiscal 2011, which included payments on long-term debt of $333,000 associated with our mortgage on our headquarters facility, and $416,000 for exchanges of shares for statutory withholding, offset by $147,000 of proceeds from the issuance of common stock for option exercises and employee stock purchases.

Contractual Obligations

Our continuing contractual obligations and commercial commitments existing on September 30, 2013 are as follows:

		Payments due by period (in thousands)			
Contractual Obligations[1]	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Long-term debt	$6,483	$871	$1,652	$1,197	$2,763
Interest on long-term debt [2]	1,301	264	420	283	334
Operating leases	3,970	1,162	1,239	569	1,000
Purchase obligations[3]	2,148	2,148	—	—	—
Total contractual cash obligations	$13,902	$4,445	$3,311	$2,049	$4,097

(1) We also have $126,000 of contractual obligations related to uncertain tax positions for which the timing and amount of payment cannot be reasonably estimated due to the nature of the uncertainties and the unpredictability of jurisdictional examinations in relation to the statute of limitations.

(2) Includes the effect of the interest-rate swap agreement that fixes the interest rate at 4.27%.

(3) Purchase obligations are commitments to purchase certain materials and supplies which will be used in the ordinary course of business.

At September 30, 2013, we had standby letters of credit totaling $1.2 million, which includes secured bank guarantees under our domestic and European credit facilities and domestic letters of credit securing certain self-insurance contracts. If we fail to meet our contractual obligations, these bank guarantees and letters of credit may become liabilities of the Company. We have no off-balance sheet arrangements or transactions, or arrangements or relationships with "special purpose entities."

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

Foreign Currency Exchange Risk. We have assessed our exposure to market risks for our financial instruments and have determined that our exposures to such risks are generally limited to those affected by the value of the U.S. dollar compared to the Euro and to a lesser extent the Australian dollar, Mexican peso, and Singapore dollar.

The terms of sales to European customers are typically denominated in Euros. We expect that our standard terms of sale to international customers, other than those in Europe, will continue to be denominated in U.S. dollars, although as we expand our operations in Australia and Latin America, transactions denominated in the local currencies of these countries may increase. As of September 30, 2013, management estimates that a 10% change in foreign exchange rates would affect net earnings before taxes by approximately $38,000 on an annual basis as a result of the conversion to U.S. dollars of cash, accounts receivable, loans to foreign subsidiaries, and sales or other contracts denominated in foreign currencies. These changes would positively affect net earnings if the U.S. dollar weakens on world markets and negatively affect net earnings if the U.S. dollar strengthens on world markets. We assess our currency exchange risk and may enter into forward contracts to minimize such risk. At September 30, 2013, we held a 30-day forward contract for €2.0 million ($2.7 million).

As of September 30, 2013, the Euro gained approximately 5% in value against the U.S. dollar compared to its value at September 30, 2012. During the twelve-month period ended September 30, 2013, changes in the value of the Euro against the U.S. dollar ranged between a 5% gain and a 1% loss as compared to the value at September 30, 2012. Most other relevant foreign currencies lost in value against the U.S. dollar during fiscal 2013. The effect of these fluctuations on our operations and financial results in fiscal 2013 were:

- Translation adjustments of $587,000, net of income tax, were recognized as a component of comprehensive income as a result of converting the Euro denominated balance sheets of Key Technology B.V. and Suplusco Holding B.V. and Visys N.V. into U.S. dollars, and to a lesser extent, the Australian dollar balance sheets of Key Technology Australia Pty Ltd., the Peso balance sheet of Productos Key Mexicana, and the Singapore dollar balance sheet of Key Technology Asia-Pacific Pte. Ltd.

- Foreign exchange losses of $146,000, net of the effects of forward contracts settled during the year, were recognized in the other income and expense section of the consolidated statement of operations as a result of conversion of Euro and other foreign currency denominated receivables, intercompany loans, 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, payables and cash carried on the balance sheets of the European, Australian, Singapore and Mexican operations.

When the U.S. dollar weakens on the world markets, our market and economic outlook for international sales could be favorably affected as products sold to international customers become relatively less expensive to those customers. Conversely, a relatively stronger U.S. dollar makes our U.S.-manufactured goods more expensive to international customers when denominated in U.S. dollars or potentially less profitable to us when denominated in a foreign currency. On the other hand, materials or components imported into the U.S. may be less expensive. Our Netherlands-based subsidiary transacts business primarily in Euros and does not have significant exports to the U.S, but does import a significant portion of its products from its U.S.-based parent company. Our Belgian-based subsidiary also transacts business primarily in Euros and is expected to have significant exports to the U.S.-based parent Company.

Interest Rate Risk. Under our domestic credit facilities, we may borrow at either (a) the lender's prime rate or prime less 25 basis points or (b) at BBA LIBOR plus 175 or 150 basis points depending on our achievement of a specified financial ratio. Our Netherlands subsidiary may borrow on our Netherlands credit facility at the lenders prime rate plus 175 basis points. Our Belgian subsidiary may borrow on our Belgian credit facility at the lender's prime rate plus

1.25%. At September 30, 2013, we had no borrowings under these arrangements. During the year ended September 30, 2013, interest rates applicable to these variable rate credit facilities ranged from 1.68% to 9.75%. At September 30, 2013, the rate was 1.68% on its domestic credit facility and 5.95% on our Netherlands credit facility and 9.75% on our Belgian credit facility based on the lowest of the available alternative rates. Our mortgage on our headquarters facility bears interest at the BBA LIBOR plus 140 basis points, but we simultaneously entered into an interest rate swap agreement with the lender to fix the interest rate a 4.27%. Long-term fixed borrowings at our Belgian subsidiary bear interest rates ranging from 2.91% to 4.99%. As of September 30,