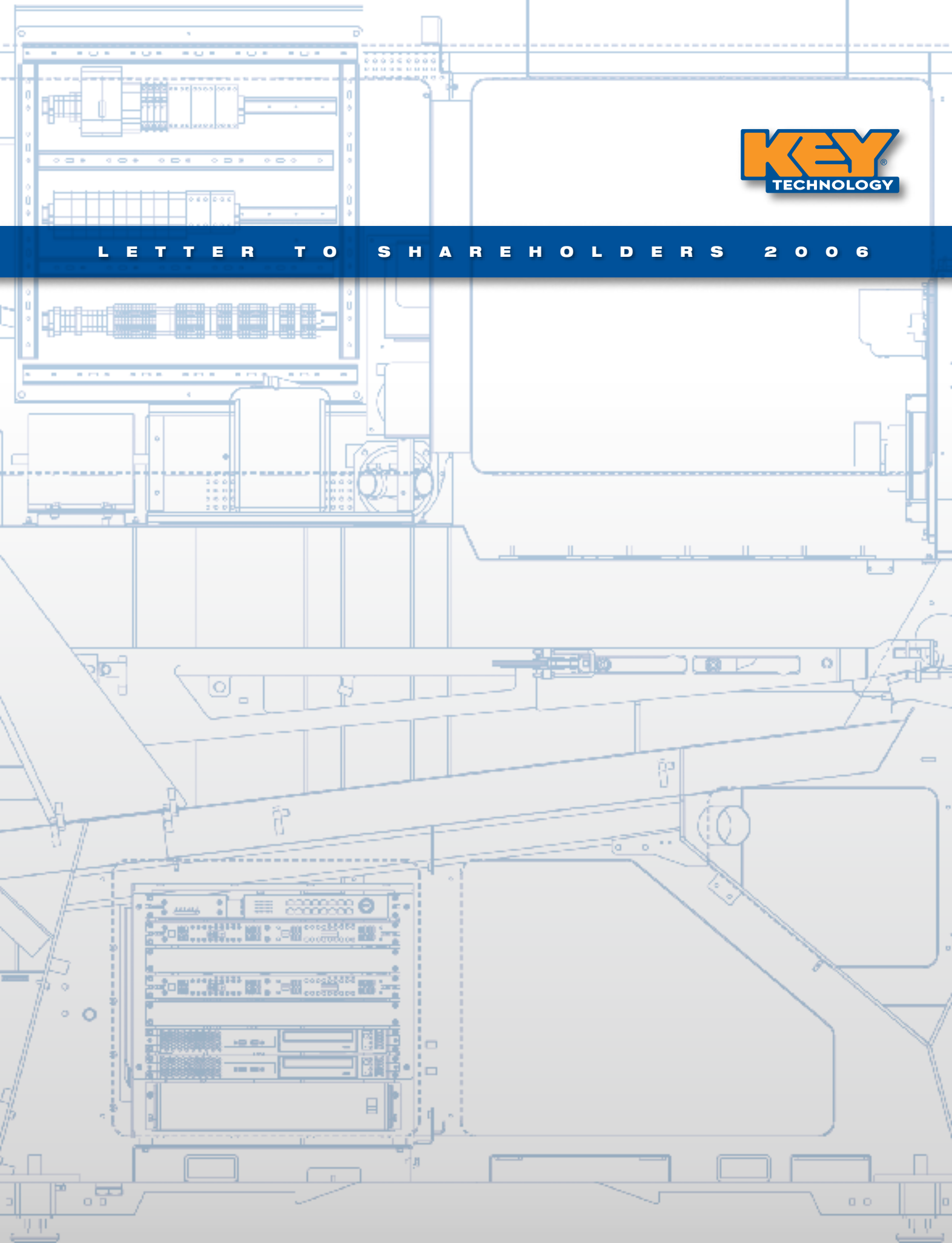




L E T T E R   T O   S H A R E H O L D E R S   2 0 0 6





David M. Camp

As stated in last year's Letter to Shareholders, Key embarked on three strategies that were unlikely to make returns to the bottom line during the year. Additionally, early in the year, the CEO left the company, presenting Key with a challenging leadership void. During the year Key took a number of cost reduction actions, including the Freshline facility closure, and the Walla Walla and Medford consolidations.

While the cost for these actions was incurred in 2006, the financial benefit will not be realized until 2007 and beyond.

In 2006 we stated our strategy as initiatives in Symetix™ (pharmaceutical/nutraceutical), China, and Aftermarket; all of which I believe constitute the correct strategy, but the benefits have not yet been realized. Committing to these initiatives and not achieving the results in the time expected, combined with the added impact of the cost reduction actions above has resulted in disappointing financial performance for 2006. My analysis is that the original plan for 2006 was too aggressive, not in direction, but in terms of when the results of the strategy would be realized.

### Key Strategy

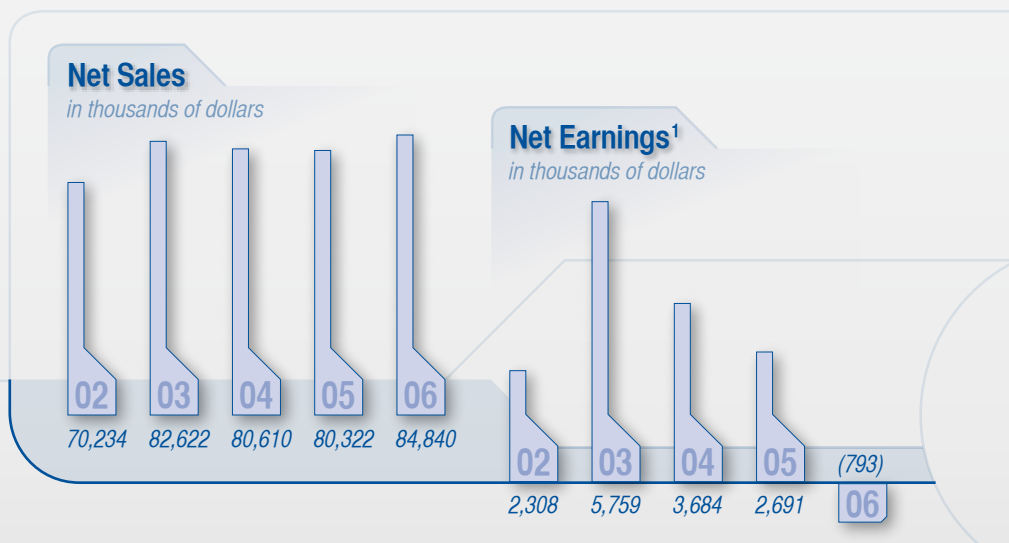
My analysis of Key's core business is that we will continue to hold the largest share of the markets we serve in the U.S., driven by our strong intellectual property position and commitment to service, but we need to be equally as well-positioned in the rest of the world. As labor in agribusiness and pharmaceutical-related industries becomes increasingly scarce and more expensive, our customers are being

driven to find more productive, labor-saving, methods; and Key is well-positioned to take advantage of this demographic trend with our Tegra®, Optyx®, and Raptor.

That being said, our customers will resist our passing on higher costs. To achieve the margins we require, we have put in place action plans to drive down these costs in 2007. My initial perspective is that providing traditional Key quality and delivery **and** meeting the requirements of global profitability will be a primary objective—essential to any adjunct growth strategy.

I believe that Key's current strategy will deliver to the bottom line. Our Aftermarket business continues to grow, with customer sales up 13%. We see strong growth in both the service and upgrade segments. And we continue to see significant growth not only supporting Key products, but also providing service and parts to other vendors' equipment on our customers' production lines. Our China initiative provides a regional sales and marketing presence and the opportunity to develop low-cost country sourcing (LCCS) initiatives. We did not fully anticipate the barriers to obtaining entry into the pharma/nutra arena with our Symetix business line, and we committed resources throughout 2006 to get the first products to the marketplace. We have a working product and have generated interest with the customer base, but Symetix has not been successfully launched at this time.

As with any strategy, there are areas where we will pay particular attention. Among the critical parameters is time-to-market for new products. Key will focus on fewer new product initiatives in the future, with a process designed to make major reductions in the time-to-market for those projects that we pursue. Our target is to reduce our time-to-market by greater than 50%.



Additionally, we must strengthen both our business analysis and research areas. Repeatable business development analyses will improve the probability of profitable growth, whether internal or external. Having access to multiple research areas is important for Key to select from a portfolio of opportunities ahead of our competition, positioning Key to always be an early converter to new opportunities. We have already identified multiple research areas in pharma/nutra where we are seeking patent protection.

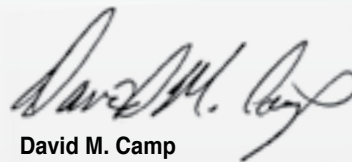
Key took actions to close three sites in 2006, and we will realize the cost benefits from these actions in 2007. Additionally, Key is already engaged in programs that will reduce manufacturing cycle time and inventory. We are shifting toward a greater emphasis on assembly and factory testing that makes the establishment of new operations quicker and less costly. This shift provides us with more flexibility and productivity in providing local capabilities for our customers. Many of our customers are requiring that Key has local manufacturing and services. In 2007, we will determine if we can achieve profitability much quicker in potential locations such as Mexico, South America, Southeast Asia and central Europe with operations designed around our core competencies of assembly and testing. However, we will not start this pursuit until we achieve expected results from our current expansion in these regions.

Key's strategy, in the near future, is to deliver on the initiatives that we have already announced, and not to take on new initiatives until returns from the existing strategy are realized. This business discipline requires us to focus our resources on the identified and approved business plans that are in place now.

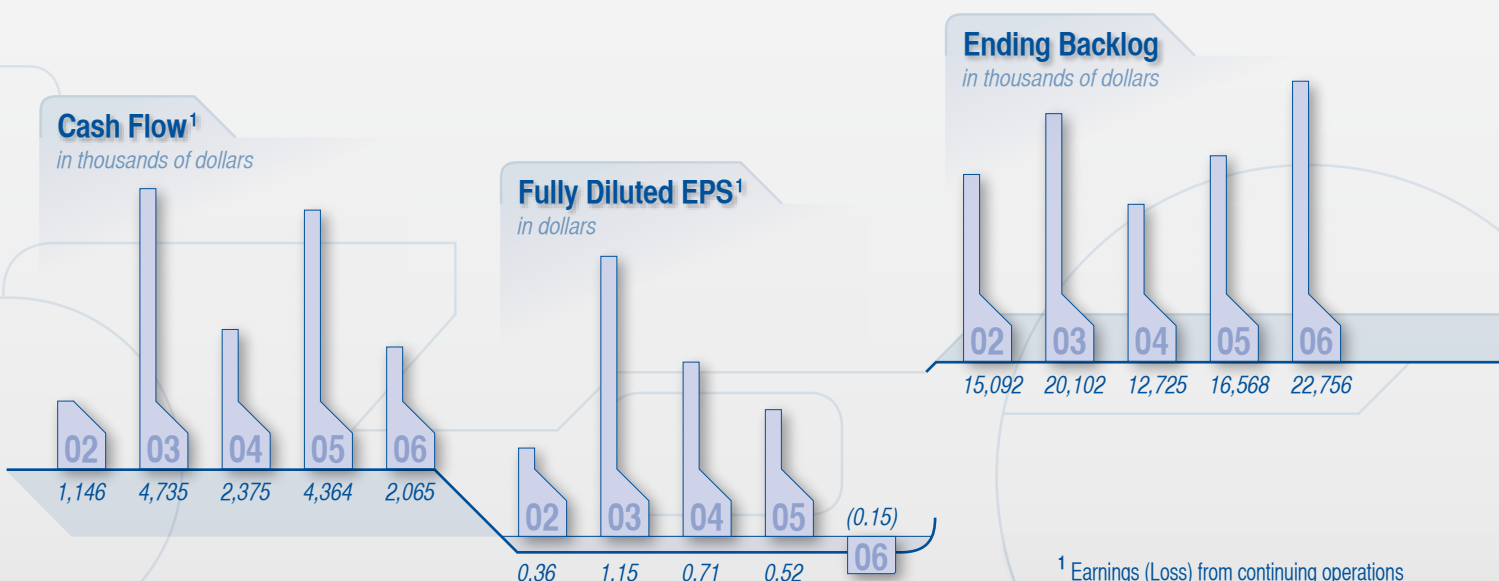
## Looking Ahead

Key is entering 2007 with the largest end-of-year backlog in the company's history at nearly \$23 M, a 36% increase from the prior year. Our backlog for our Automated Inspection Systems has increased by 69% year-over-year, an indication that the new products we are bringing to the market have value to our customers. Our operations in the Netherlands, Mexico, and China continue to grow market acceptance. The management team's challenge is not to find enough opportunities, it is to focus on those opportunities that provide both value to our customers and our shareholders.

We do not believe that the results of 2006 require a shift in strategy; we believe the results show that we have not yet obtained the results of the strategy. Key has a strong team of employees who have embraced this direction. They see that we are evolving quickly into a company committed to providing consistently healthy bottom-line results. Our excellent staff of Key employees are working here because they see the opportunities for their futures with a successful company. We are a global partner to our customers, helping them produce consistent high quality products cost effectively, and we have a responsibility to our investors to do this profitably. These are the complementary benchmarks by which to measure ourselves. We are committed to achieving both objectives.



**David M. Camp**  
President and CEO



## Directors & Officers

**John C. Boutsikaris**  
Senior Vice President of  
Sales and Marketing

**Ronald W. Burgess**  
Senior Vice President and  
Chief Financial Officer

**David M. Camp, Ph.D.**  
Director  
President and  
Chief Executive Officer

**Thomas C. Madsen**  
Chairman of the Board

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

**John E. Pelo**<sup>1,3</sup>  
Director  
President and Chief  
Executive Officer,  
Swire Coca-Cola USA

**Michael L. Shannon**<sup>2,3</sup>  
Director  
Principal, Concerto  
Development LLC

**Charles H. Stonecipher**<sup>1,3</sup>  
Director  
Former Executive Vice President of  
Product Development and  
Strategy, Advanced Digital  
Information Company

**Donald A. Washburn**<sup>1,2,3</sup>  
Director  
Private Investor  
Director, Amedisys, Inc.  
Director,  
The Greenbrier Companies  
Trustee,  
LaSalle Hotel Properties

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

## Corporate Headquarters

**Key Technology, Inc.**  
150 Avery Street  
Walla Walla, WA 99362  
(509) 529-2161  
www.key.net

## Other Locations

**Freshline Machines, Pty. Ltd.**  
A Division of Key Technology  
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Seven Hills NSW 2147  
Sydney, Australia

**Key Technology Australia Pty. Ltd.**  
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Dingley  
Victoria, Australia 3172

**Key Technology BV**  
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4112 NE Beusichem  
The Netherlands

**Key Technology, Inc.**  
2067 Commerce Drive  
Medford, OR 97504

**Key Technology, Inc.**  
975 SW First Street  
Redmond, OR 97756

**Key Technology (Shanghai)  
Trading Co. Ltd.**  
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Waigaoqiao Free Trade Zone  
Shanghai, China  
200131

**Productos Key Mexicana,  
S. de R.L. de C.V.**  
Acceso II No. 01 Interior 02  
Parque Industrial Benito Juárez  
Santiago de Querétaro, Qro. 76130  
México

## Stock Listing

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

## Corporate Information

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**Auditors**  
Grant Thornton LLP  
Seattle, WA

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Local:  
(718) 921-8200  
Fax:  
(718) 236-2641

## Shareholder Information

**Key Technology, Inc.  
Investor Relations**  
150 Avery Street  
Walla Walla, WA 99362  
Website: www.key.net  
Email: investor.info@key.net

**Annual Meeting of Shareholders**  
8:00 a.m. Wednesday  
February 7, 2007  
Key Technology  
Corporate Headquarters

1 Member of the Audit Committee of the Board of Directors  
2 Member of the Compensation Committee of the Board of Directors  
3 Member of the Nominating and Corporate Governance Committee of the Board of Directors

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

Comments included in this document may include "forward-looking statements" within the meaning of the federal securities laws, including statements as to anticipated future results that are based on current expectations and subject to a number of risks and uncertainties. It is important to note that the Company's actual results could differ materially from those projected in such forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those in forward-looking statements is contained from time to time in the Company's SEC filings, including, but not limited to the Company's report on Form 10-K for the year ended September 30, 2006.