VALLEY FORGE SCIENTIFIC CORP
Form 10-Q
August 15, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2005

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____
Commission File Number: 001-10382

VALLEY FORGE SCIENTIFIC CORP.
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	23-2131580
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

3600 Horizon Drive, King of Prussia, Pennsylvania 19406
(Address of principal executive offices and zip code)
Telephone: (484) 690-9000

136 Green Tree Road, Oaks, Pennsylvania 19456
(Former address of Registrant)

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

Yes [X] No [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

At August 11, 2005 there were 7,939,712 shares outstanding of the Registrant's no par value Common Stock.

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VALLEY FORGE SCIENTIFIC CORP.

INDEX TO FORM 10-Q

June 30, 2005

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	June 30, 2005 (Unaudited)	Sep (
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 2,386,742	$
Accounts receivable - net	941,778	
Inventory	792,385	
Loans receivable - stockholder/officer	14,100	
Prepaid items and other current assets	107,510	
Deferred tax assets	89,242	
Total Current Assets	4,331,757	
Property, plant and equipment - net	221,101	
Goodwill	153,616	
Intangible assets - net	187,875	
Loans receivable - stockholder/officer	22,182	
Other assets	27,477	
Total Assets	$ 4,944,008	$
LIABILITIES AND STOCKHOLDERS' EQUITY		

Current Liabilities:		
Accounts payable and accrued expenses	$ 423,890	$
Income taxes payable	55,713	
Deferred revenue	-	
Total Current Liabilities	479,603	
Deferred Tax Liability	15,313	
Total Liabilities	494,916	
Commitment		
Stockholders' Equity:		
Preferred stock	-	
Common stock (no par, 20,000,000 shares authorized, shares issued and outstanding at June 30, 2005 - 7,939,712 and September 30, 2004 - 7,913,712)	3,589,130	
Retained earnings	859,962	
Total Stockholders' Equity	4,449,092	
Total Liabilities and Stockholders' Equity	$ 4,944,008	$

See accompanying notes to consolidated financial statements.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For the Three Months Ended June 30,		F
	2005	2004	
Net Sales	$ 1,697,982	$ 1,274,389	$
Cost of Sales	738,347	622,068	
Gross Profit	959,635	652,321	
Other Costs:			
Selling, general and administrative	526,223	417,699	
Merger related professional fees	436,729	-	
Research and development	108,307	114,754	
Amortization	10,175	10,147	

Total Other Costs	1,081,434	542,600	
Income (Loss) from Operations	(121,799)	109,721	
Other Income (Expense)			
Settlement of lawsuit	-	-	
Gain from disposition of property	111,674	-	
Interest income	11,197	5,868	
Total Other Income (Expense)	122,871	5,868	
Income before Income Taxes	1,072	115,589	
Provision for Income Taxes	890	50,583	
Net Income	$ 182	$ 65,006	$
Income per Share:			
Basic income per common share	$ 0.00	$ 0.01	$
Diluted income per common share	$ 0.00	$ 0.01	$
Basic weighted average common shares outstanding	7,919,250	7,913,712	
Diluted weighted average common shares outstanding	8,071,672	7,994,955	

See accompanying notes to consolidated financial statements.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	For the Nine Months Ended June 30,	
	2005	2004
Cash Flows from Operating Activities:		
Net income	$ 139,066	$ 145,5
Adjustments to reconcile net income to net cash (used in) operating activities:		
Depreciation and amortization	54,571	52,6
Gain from disposition of property	(111,674)	
Interest accrued on loans and advances to		

employees and related parties	(1,540)	(1,7
Provision for obsolete and slow-moving inventory	-	58,7
Deferred income taxes	(9,490)	(28,5
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(295,554)	(393,3
Inventory	(10,781)	(127,0
Prepaid items and other current assets	(2,891)	136,4
Other assets	(770)	(1,1
Increase (decrease) in:		
Accounts payable and accrued expenses and income taxes payable	227,284	70,3
Deferred tax liabilities	(430)	(5
Deferred revenue	(5,750)	9,6
Net cash (used in) operating activities	(17,959)	(78,8
Cash Flows from Investing Activities:		
Purchases of property, plant and equipment	(171,296)	(9,8
Proceeds from disposition of property (net of closing cost)	185,788	
Proceeds from repayments of loans to stockholder	7,050	6,5
Costs related to patent application	-	(1,3
Net cash provided by (used in) investing activities	21,542	(4,7
Cash Flows from Financing Activities:		
Proceeds from exercise of options	60,600	
Net cash provided by financing activities	60,600	
Net Change in Cash and Cash Equivalents	64,183	(83,5
Cash and Cash Equivalents - Beginning of Period	2,322,559	2,305,5
Cash and Cash Equivalents - End of Period	$ 2,386,742	$ 2,221,9
Schedule of non-cash operating and investing activities:		
Use of deposit for acquisition of property, plant and equipment	$ 14,400	$
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Income taxes	$ 70,056	$ 11,7
Interest	-	

See accompanying notes to consolidated financial statements.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JUNE 30, 2005

NOTE 1 - DESCRIPTION OF BUSINESS:

Valley Forge Scientific Corp. ("VFSC") was incorporated on March 27, 1980 in the Commonwealth of Pennsylvania and is engaged in the business of developing, manufacturing, and selling medical devices and products. On August 18, 1994, VFSC formed a wholly-owned subsidiary, Diversified Electronics Company, Inc. ("DEC"), a Pennsylvania corporation, in order to continue the operations of Diversified Electronic Corporation, a company which was merged with and into VFSC on August 31, 1994. Collectively, VFSC and DEC are referred to herein as the "Company".

On May 2, 2005, the Company entered into a merger agreement with Synergetics, Inc. ("Synergetics"), a privately-held corporation, to combine the two companies. Under the terms of the merger agreement, the stockholders of Synergetics' will receive approximately 16 million shares of the Company's common stock. As a result of the merger, the former stockholders of Synergetics will represent approximately 66% of the Company's outstanding common stock on a fully diluted basis. The merger is subject to the satisfaction of a number of closing conditions, including stockholder and regulatory approvals.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation and Basis of Presentation

The accompanying financial statements consolidate the accounts of VFSC and its wholly-owned subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission and, therefore, do not include all information and footnote disclosures normally included in audited financial statements. However, in the opinion of management, all adjustments that are of a normal and recurring nature, necessary to present fairly the results of operations, financial position, and cash flows have been made. It is suggested that these statements be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K for the year ended September 30, 2004.

The statements of operations for the three and nine months ended June 30, 2005 are not necessarily indicative of results for the full year.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

Earnings per Share

The Company computes earnings per share in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share" (SFAS 128). Basic earnings per share are computed by dividing income available to common stockholders by the weighted average number of common shares outstanding. Diluted earnings per share reflect the potential dilution that could occur if securities or other agreements to issue common stock were exercised or converted into common stock. Diluted earnings per share is computed based upon the weighted average number of common shares and dilutive common equivalent shares outstanding, which include convertible debentures, stock options, and warrants.

Recently Issued Accounting Standards

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment," which replaces SFAS 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), and supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"). SFAS 123(R) requires companies to recognize in their income statement the grant-date fair value of stock options and other equity-based compensation issued to employees. The Company is required to adopt SFAS 123(R) beginning January 1, 2006. Grant-date fair value will be determined using one of two acceptable valuation models. This Standard requires that compensation expense for most equity-based awards be recognized over the requisite service period, usually the vesting period; while compensation expense for liability-based awards (those usually settled in cash rather than stock) be re-measured to fair-value at each balance sheet date until the award is settled. The Standard also provides guidance as to the accounting treatment for income taxes related to such compensation costs, as well as transition issues related to adopting the new Standard. The Company has been using the intrinsic value method as set forth under APB No. 25 with no stock-based compensation cost reflected in net earnings while complying with footnote disclosure requirements of SFAS No. 123 setting forth the pro forma effect on net earnings of applying fair value recognition to stock based awards. The Company is currently evaluating the impact on its operations of the adoption SFAS 123(R).

In December 2004, the FASB issued SFAS No. 153, "Exchange of Non-monetary Assets an amendment of APB Opinion No. 29." This Statement precludes companies from using the "similar productive assets" criteria to account for non-monetary exchanges at book value with no gain or loss being recognized. Effective for fiscal periods beginning after June 15, 2005, all companies will be required to use fair value for most non-monetary exchanges, recognizing gain or loss, if the transaction meets commercial, substance criteria. The Company does not expect this Standard to have a significant impact on its current consolidated financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

Recently Issued Accounting Standards (Continued)

In November 2004, the FASB issued Statement No. 151, "Inventory Costs, an amendment of ARB 43, Chapter 4" ("SFAS 151"), to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage). ARB 43 allowed some of these "abnormal costs" to be

carried as inventory, whereas the new Standard requires that these costs be expensed as incurred. This Statement is effective for fiscal years beginning after June 15, 2005. The Company is currently evaluating what effect, if any, this standard will have on its current consolidated financial statements.

In December 2004, the FASB issued FSP FAS 109-1, "Application of FASB Statement No. 109, "Accounting for Income Taxes," to the "Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004" to provide accounting guidance on the appropriate treatment of tax benefits generated by the enactment of the Act. The FSP requires that the manufacturer's deduction be treated as a special deduction in accordance with SFAS 109 and not as a tax rate reduction. The Company is awaiting final tax regulations from the IRS before completing its assessment of the impact of adopting FSP FAS 109-1 on its current consolidated financial statements.

Stock-Based Compensation

In December 2002, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123." SFAS No. 148 amended SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amended the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 was effective for the Company as of January 1, 2003. The Company has not elected a voluntary change in accounting to the fair value based method. Accordingly, the adoption of SFAS No. 148 did not have a significant impact on the Company's results of operations or financial position.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

Stock-Based Compensation (Continued)

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in subjective input assumptions can materially affect the fair value estimated, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options. In addition, option pricing models require the input of highly subjective assumptions, including expected stock price volatility.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. In accordance with SFAS 123 and 148, only stock options granted after September 30, 1995, have been included for the Company's pro forma information as follows:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2005	2004	2005	2004
Net income - as reported	$ 182	$ 65,006	$ 139,066	$ 145,564
Less: total compensation expense determined under fair value based method - net of tax effect	51,545	9,839	70,131	54,981
Pro Forma Net Income (Loss)	$ (51,363)	$ 55,167	$ 68,935	$ 90,583
Pro Forma Income (Loss) Per Share:				
Basic	$ (0.01)	$ 0.01	$ 0.01	$ 0.01
Diluted	$ (0.01)	$ 0.01	$ 0.01	$ 0.01

Revenue Recognition

Product revenue is recognized when the product has been shipped, which is when title and risk of loss has been transferred to the customer.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JUNE 30, 2005

NOTE 3 - DISTRIBUTION AGREEMENTS:

The Company sells its products to U.S. based national and international distributors and dealers including those as described below:

Codman and Shurtleff, Inc. ("Codman")

A significant part of the Company's sales were made pursuant to a distribution agreement with Codman, an affiliate of a major medical company and the Company's largest customer. On October 15, 2004, the Company executed a new agreement with Codman for the period October 1, 2004 through December 31, 2005. The agreement, as amended, provides for exclusive worldwide distribution rights of the Company's existing neurosurgery products in the fields of neurocranial and neurospinal surgery until July 15, 2005, and non-exclusive rights in these fields from July 15, 2005 through December 31, 2005. The agreement also provides that the distribution agreement can each be extended by mutual consent of the parties.

Stryker Corporation ("Stryker")

On October 25, 2004, the Company executed a Supply and Distribution Agreement

("the Agreement") with Stryker (a Michigan corporation) which provides for the Company to supply to Stryker and for Stryker to distribute exclusively, on a world-wide basis, a generator for the percutaneous treatment of pain. The Agreement is for a term of five years after the first acceptance of the generator by Stryker, which was on November 11, 2004.

NOTE 3 - DISTRIBUTION AGREEMENTS (CONTINUED):

Stryker Corporation ("Stryker") (Continued)

There is a minimum purchase obligation that is specified by "Agreement Year." The first Agreement Year commenced on the date of the first acceptance by Stryker of a generator product delivered by the Company as ready for commercial sale, which was November 11, 2004, and ends on the last day of the calendar quarter in which the first anniversary date of such inception date occurs. In the first Agreement Year, Stryker is required to make minimum purchases of $900,000 comprised of demonstration and commercial sales units. In the second and third Agreement Years, Stryker is required to make minimum purchases in each year of $500,000 of commercial sales units. After only eight months into the first Agreement Year, Stryker has already exceeded the minimum purchases for the first Agreement Year.

On or before the beginning of the last calendar quarter of the third Agreement Year, and each Agreement Year thereafter, the Company and Stryker will conduct good faith negotiations regarding the minimum purchase obligation for the next Agreement Year. Also, during the first two months of the last calendar quarter in any Agreement Year, the Company and Stryker will conduct good faith negotiations regarding changes in prices that will take effect on the first day of the ensuing Agreement Year. The Agreement also provides Stryker certain rights for other new product concepts developed by the Company in both pain control and expanded market areas. The Agreement contains various terms related to the provision of repair services for the product by the Company and maintenance of spare parts, the distributor's obligation to market the product, to provide training to sales personnel, and other provisions.

NOTE 4 - OPTION AGREEMENT:

On October 22, 2004, the Company entered into an Option Agreement with Dr. Leonard I. Malis, a director and stockholder of the Company, giving the Company the right to purchase from Dr. Malis his Malis (R) trademark at any time over a period of five years. The Company paid Dr. Malis $35,000 for the option and is required to pay an annual fee before each anniversary of the option agreement in the amount of $20,000 for each of the first two anniversaries and increasing to $60,000 before the fourth anniversary in order to keep the option in effect from year to year. The exercise price of the option is $4,157,504, which includes interest, and will be payable in 26 quarterly installments of $159,904, which will be evidenced by a promissory note payable to Dr. Malis. This note would be secured by a security interest in the Company's rights to the Malis (R) trademark and certain of the Company's patents.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JUNE 30, 2005

NOTE 5 - SUPPLEMENTAL BALANCE SHEET INFORMATION:

Accounts Receivable - Net

	June 30, 2005 (Unaudited)	September 30, 2004 (Audited)
Accounts receivable	$ 957,258	$ 661,704
Less: Allowances	15,480	15,480
Accounts receivable - net	$ 941,778	$ 646,224

Inventory

	June 30, 2005 (Unaudited)	September 30, 2004 (Audited)
Finished goods	$ 57,178	$ 94,405
Work-in-process	371,858	396,810
Materials and parts	516,165	424,052
	945,201	915,267
Less: Allowances for slow moving and obsolete inventory	152,816	133,663
	$ 792,385	$ 781,604

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JUNE 30, 2005

NOTE 5 - SUPPLEMENTAL BALANCE SHEET INFORMATION (CONTINUED):

Property, Plant and Equipment - Net

	Useful Life (Years)	June 30, 2005	September 30, 2004

		(Unaudited)	(Audited)
Furniture and fixtures	5 - 7	$ 17,953	$ 17,953
Laboratory equipment	5 - 10	463,652	378,159
Office equipment	5	193,312	185,530
Leasehold improvements	3 - 5	87,194	9,413
Land	-	-	11,953
Buildings and improvements	15 - 39	-	103,467
		762,111	706,475
Less: Accumulated depreciation and amortization		541,010	558,508
		$ 221,101	$ 147,967

Depreciation amounted to $8,609 and $7,318 for the three months ended June 30, 2005 and 2004, respectively, and $24,048 and $22,363 for the nine months ended June 30, 2005 and 2004, respectively.

On June 27, 2005, the Company sold all of the property and certain equipment of DEC for $185,788. The income recognized by the Company is $111,674, before moving costs and taxes.

NOTE 5 - SUPPLEMENTAL BALANCE SHEET INFORMATION (CONTINUED):

Goodwill and Intangible Assets

In accordance with SFAS 142, goodwill has been reflected on the balance sheet separate from other intangible assets which continue to be amortized. No change in the carrying amount of goodwill was made for the quarter ended June 30, 2005. The Company completed its annual impairment test during the quarter ended March 31, 2005 and no impairment was identified.

Information regarding the Company's other intangible assets is as follows:

Goodwill and Intangible Assets

	June 30, 2005 (Unaudited)			September 30, 200	
	Gross Carrying Value	Accumulated Amortization	Net	Gross Carrying Value	Accumulat Amortizat

Patents, trademarks and licensing agreements	$ 573,804	$ 511,583	$ 62,221	$ 573,804	$ 503,6
Proprietary know-how	452,354	326,700	125,654	452,354	304,0
Acquisition costs	55,969	55,969	-	55,969	55,9
	$ 1,082,127	$ 894,252	$ 187,875	$ 1,082,127	$ 863,7

Amortization expense of intangible assets amounted to $10,175 and $10,147 for the three months ended June 30, 2005 and 2004, respectively, and $30,523 and $30,296 for the nine months ended June 30, 2005 and 2004, respectively.

Annual amortization expense is estimated to be $40,800 for fiscal 2005, $40,800 for fiscal 2006, $40,700 for fiscal 2007, $40,100 for fiscal 2008, $34,900 for fiscal 2009 and $21,100 thereafter.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JUNE 30, 2005

NOTE 6 - LOANS RECEIVABLE - STOCKHOLDER/OFFICER:

Loans receivable - stockholder/officer represent various loans to Jerry L. Malis, a principal stockholder, director and officer of the Company. The loans bear interest at rates of 4.83% to 6.97% and are payable in either quarterly installments of $3,525 or annual installments of $14,100 until the principal and accrued interest have been repaid. At June 30, 2005, loans receivable - stockholder amounted to $36,282. At June 30, 2005, the stockholder/officer was current on the loan receivable.

Loans receivable - stockholder/officer are partially secured by 5,833 shares of the Company's common stock. At June 30, 2005, the pledged common stock has a value of $23,215.

NOTE 7 - COMMITMENT:

Operating Lease

The Company leased approximately 4,200 square feet of office and warehouse space from a general partnership whose partners are Jerry L. Malis, Leonard I. Malis (principal stockholders, directors and officers of the Company) and the Frances W. Gilloway Marital Trust. The lease expired June 30, 2005.

The Company entered into a combination sublease and lease commencing on May 1, 2005 for a term of four and one-half years, for office, assembly and manufacturing space in King of Prussia, Pennsylvania, with an initial annual rental of $74,858, increasing to $129,437, plus annual operating expenses.

Rent expense amounted to $33,383 and $64,317 for three and nine months ended June 30, 2005, respectively, and $15,017 and $45,050 for the three and nine months ended June 30, 2004, respectively. Rent expense to the related entity amounted to $15,599 and $46,533 for three and nine months ended June 30, 2005, respectively, and $15,017 and $45,050 for the three and nine months ended June 30, 2004, respectively.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
JUNE 30, 2005

NOTE 8 - EARNINGS PER SHARE:

	Three Months Ended June 30,		Nine Months Ende June 30,	
	2005	2004	2005	200
Income available to common stockholders	$ 182	$ 65,006	$ 139,066	$ 14
Weighted average common shares outstanding - basic	7,919,250	7,913,712	7,915,558	7,91
Net effect of dilutive shares issuable in connection with stock plans	152,422	81,243	85,337	6
Weighted average common shares outstanding - diluted	8,071,672	7,994,955	8,000,895	7,97
Earnings Per Share:				
Basic	$ 0.00	$ 0.01	$ 0.02	$
Diluted	$ 0.00	$ 0.01	$ 0.02	$

Options to purchase 431,500 and 507,250 shares of common stock were outstanding on June 30, 2005 and 2004, respectively. Of these shares, 279,078 and 426,007 shares were not included in the computation of diluted earnings per share for the three months ended June 30, 2005 and 2004, and 346,163 and 441,496 of these shares were not included in the computation of diluted earnings per share for the nine months ended June 30, 2005 and 2004, respectively, in accordance with SFAS 128, as the issuance prices were in excess of the average market price for the period.

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

The following is a discussion and analysis of Valley Forge Scientific Corp.'s financial condition and results of operations for the quarterly and nine month periods ended June 30, 2005 and 2004. This section should be read in conjunction with the financial statements and related notes in Item 1 of this report and Valley Forge Scientific Corp.'s annual report on Form 10-K for the year ended September 30, 2004, which has been filed with the Securities and Exchange Commission. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward looking statements as a result of many factors including but not limited to those under the headings "Special Note Regarding Forward Looking Statements" and "Factors That

Might Affect Future Results". Unless the context requires otherwise, references to "we", "us", "our" and "Valley Forge Scientific" refer to Valley Forge Scientific Corp.

Overview

Valley Forge is a medical device company that develops, manufactures and sells medical devices for use in surgery and other healthcare applications. Our core business involves the sale of bipolar electrosurgical generators and other generators, based on our DualWave(TM) technology, and complementary instrumentation and disposable products.

Our current line of bipolar electrosurgical products are used in neurosurgery and spine surgery and in dental applications. In the first quarter of fiscal 2005, we commenced selling to Stryker Corporation a lesion generator for the percutaneous treatment of pain. We plan to expand the market for our products with the introduction of our new multifunctional bipolar electrosurgical generator and new proprietary single-use, hand-switching bipolar instruments, new products based on our proprietary lesion generator technology, and other products and product refinements. Our new multifunctional bipolar electrosurgical system is designed to replace other surgical tools, such as monopolar electrosurgical systems and lasers, in certain applications.

We believe our DualWave(TM) technology distinguishes our products from our competitors. With appropriate technique, our bipolar electrosurgical systems based on our DualWave(TM) technology allow a surgeon or dentist to cut tissue in a manner that minimizes collateral damage to surrounding healthy tissue and to coagulate blood vessels quickly, safely and efficiently. By substantially reducing damage to surrounding healthy tissue, the surgeon or dentist can work safely in close proximity with nerves, blood vessels and bone. Our bipolar electrosurgical systems can also be used in close proximity with metal implants and in irrigated fields.

Merger Agreement with Synergetics, Inc.

On May 2, 2005, we entered into a merger agreement with Synergetics, Inc., a privately-held corporation, that is involved in the development, manufacture, distribution and sale of durable and disposable instruments for use in retina surgery, neurosurgery and other microsurgery markets. Pursuant to the terms of the merger agreement, Synergetics' shareholders will receive, in the

aggregate, approximately 16 million fully paid and nonassessable shares of Valley Forge's common stock, no par value, or approximately 66% of Valley Forge's then outstanding common stock on a fully diluted basis. Completion of the merger is subject to several conditions, including approval by shareholders of each company, effectiveness of a Form S-4 registration statement, and other customary closing conditions. Additionally, the merger agreement may be terminated by Valley Forge or Synergetics upon the occurrence or failure to occur of certain events, including a failure of the merger to be consummated by September 30, 2005. In the event of such termination, under certain circumstances, Valley Forge and Synergetics may be required to pay each other a break-up fee of $1 million as set forth in the merger agreement.

The merger agreement provides that the board of directors of Valley Forge following the merger will consist of seven directors including two current directors of each of Synergetics and Valley Forge and three additional independent directors. Four of the seven directors will be independent.

Certain directors, executive officers and shareholders of Valley Forge holding approximately 35 percent of outstanding shares of Valley Forge's common stock and directors and executive officers of Synergetics holding approximately 19 percent of shares of Synergetics' common stock have agreed to vote in favor of the merger, pursuant to voting agreements dated May 2, 2005. A majority of the outstanding shares of the Valley Forge common stock, and two-thirds of the outstanding shares of Synergetics' common stock, are required to approve the merger.

Codman Agreement

For over 20 years, we have had worldwide exclusive distribution agreements with Codman & Shurtleff, Inc. ("Codman"), a subsidiary of Johnson & Johnson, Inc., to market our neurosurgery bipolar electrosurgical systems and other products in the fields of neurocranial and neurospinal surgery. On October 15, 2004, we entered into a new agreement with Codman defining our business relationship from October 1, 2004 through December 31, 2005. This Agreement was amended effective March 1, 2005. Pursuant to that amendment, on July 15, 2005, the distribution agreement with Codman became a nonexclusive agreement.

Historically, we have derived a significant portion of our sales from sales to Codman. For the three and nine months ended June 30, 2005, 85% and 74%, respectively, of our revenue was derived from sales to Codman, and for the fiscal year ended September 30, 2004, 86% of our revenue was derived from sales to Codman.

Stryker Agreement

On October 25, 2004, we entered into a supply and distribution agreement with Stryker Corporation for the distribution and sale of a lesion generator manufactured by Valley Forge for the percutaneous treatment of pain. The supply and distribution agreement is the culmination of over two years of collaborative efforts with Stryker. The term of the supply and distribution agreement is for slightly over five years, commencing on November 11, 2004 and ending on March 31, 2009, and grants Stryker exclusive worldwide marketing rights for distribution and sale of the lesion generator

for use in percutaneous treatment of pain. In the first year of the agreement, Stryker has agreed to make minimum purchases of approximately $900,000 for a combination of sales demonstration units and commercial sale units. In the second and third years, Stryker has agreed to make minimum purchases of approximately $500,000 per year for commercial sale units. Minimum purchase requirements for agreement years four and five are to be determined by the parties based on market conditions and other factors. After only eight months into the first year of the supply and distribution agreement, Stryker has already exceeded the first year minimum purchases of $900,000 as set forth in that agreement. The agreement also provides Stryker certain rights for other new product concepts developed by Valley Forge in both pain control and expanded market areas.

Results of Operations

Results of Operations for the Three and Nine Months Ended June 30, 2005 compared to the Three and Nine Months Ended June 30, 2004.

Summary

Sales of $1,697,982, for the three months, and $4,926,387 for the nine months, ended June 30, 2005 were 33% and 37% greater, respectively, than sales of $1,274,389 and $3,606,629, respectively, for the three and nine months ended June 30, 2004. Primarily as a result of one-time merger related professional fees of $436,729 for the third quarter of fiscal 2005 and $518,895 for the first nine months of fiscal 2005, we had an operating loss of $121,799 for third quarter of fiscal 2005 and operating income of $254,354, as compared to operating income of $109,721 and $245,191 for the corresponding periods in fiscal 2004 Net income for the three and nine months ended June 30, 2005 was $182 and $139,066, respectively, as compared to net income of $65,006 and $145,564, respectively, for the corresponding periods in fiscal 2004.

Sales

Total Sales and Gross Profit on Sales:

	Unaudited Three Months Ended June 30,		Unaudited Nine Months Ended June 30,	
	2005	2004	2005	2004
Total sales:	$1,697,982	$1,274,389	$4,926,387	$3,606,629
Cost of sales:	738,347	622,068	2,221,128	1,689,236
Gross profit on sales:	959,635	652,321	2,705,259	1,917,393
Gross profit as a percentage of sales:	57%	51%	55%	53%

The increase in sales in the third quarter and first nine months of the 2005 fiscal year as compared to the third quarter and first nine months of the 2004 fiscal year reflects increased sales to Stryker of a lesion generator model we developed for the percutaneous treatment of pain, and increased sales to Codman. Sales for our dental products decreased for the third quarter and the first nine months of fiscal 2005.

For the third quarter of fiscal 2005, sales to Codman accounted for 85% of our sales and sales to Stryker accounted for 10% of our sales, as compared to 82% and 9%, of our sales, respectively, for the third quarter of fiscal 2004. For the first nine months of fiscal 2005, sales to Codman accounted for 74% of our sales and sales to Stryker accounted for 20% of our sales, as compared to 84% and 4% of our sales, respectively, for the first nine months of fiscal 2004.

During the third quarter and first nine months of fiscal 2005, we had sales to Stryker of $177,730 and $965,779, respectively, pursuant to a supply and distribution agreement, which we entered into on October 25, 2004. There were sales of $120,000 and $135,000, respectively, of this product during the third quarter and first nine months of fiscal 2004. After only eight months into the first year of the supply and distribution agreement, Stryker has already exceeded the first year minimum purchases of $900,000 as set forth in that agreement.

Sales of our neurosurgical products and related services to Codman increased to $1,438,304 for the three months, and $3,628,436 for the nine months, ended June 30, 2005 as compared to sales of $1,040,347 and $3,044,868

for the three and nine months ended June 30, 2004. During this time, Codman was the exclusive distributor of our existing products in fields of neurocranial and neurospinal surgery. Subsequent to the end of the quarter, effective July 15, 2005, Codman became the nonexclusive worldwide distributor of our existing products in the fields of neurocranial and neurospinal surgery until December 31, 2005. We anticipate that sales to Codman in the fourth quarter of fiscal 2005 will be at a lower level than the sales to Codman for the third quarter of fiscal 2005.

For the three and nine months ended June 30, 2005, sales of the Bident(R) Bipolar Tissue Management System for dental applications were $79,708 and $298,879, respectively, or 5% and 6% of sales, respectively, as compared to $107,948, or 8% of sales, and $398,563, or 11% of sales, respectively, for the corresponding periods in 2004. We are considering product modifications and other strategies for our dental products.

Sales by Medical Field:

The table below sets forth our sales by medical field of "Generators, Irrigators and Other Products" and "Disposable Products" for the three months and nine months ended June 30, 2005, and 2004. Sales of "Disposable Products" in "Other fields" represent sales to Boston Scientific Corporation and direct sales to hospitals.

	For the Three Months Ended June 30,		For the Nine Months Ended June 30,	
	2005	2004	2005	2004
Generators, Irrigators and Accessory Products				
Neurosurgery field	$ 904,770	$ 503,852	$2,122,702	$1,552,478
Dental field	64,583	85,125	251,858	341,755
Pain Control fields	150,000	120,000	937,500	135,000
Total of all fields:	$1,119,353	$ 708,977	$3,312,060	$2,029,233
Disposable Products				
Neurosurgery field	$ 480,484	$ 508,306	$1,338,857	$1,313,030
Dental field	13,960	24,572	43,492	56,809
Other fields	2,240	1,963	15,476	30,218
Total of all fields:	$ 496,684	$ 534,841	$1,397,825	$1,400,057

For the third quarter of fiscal 2005, 66% of our sales related to sales of bipolar electrosurgical generators, irrigators and accessories as compared to approximately 56% of our sales for the third quarter of fiscal 2004. Sales of disposable products accounted for approximately 29% of our sales in the third quarter of fiscal 2005 as compared to approximately 42% of our sales in the third quarter of fiscal 2004.

For the first nine months of fiscal 2005, 67% of our sales related to sales of bipolar electrosurgical generators, irrigators and accessories as compared to

approximately 56% of our sales for the first nine months of fiscal 2004. Sales of disposable products accounted for approximately 28% of our sales in the first nine months of fiscal 2005, as compared to approximately 39% of our sales in the first nine months of fiscal 2004.

Cost of Sales

Cost of sales was 43% of sales for the three months, and 45% for the nine months, ended June 30, 2005 as compared to 49% and 47% of sales for the three months and nine months ended June 30, 2004. Gross margin was 57% for the three months, and 55% for the nine months, ended June 30, 2005 as compared to 51% for the three months, and 53% for the nine months, ended June 30, 2004. The higher gross margin for the three months and nine months ended June 30, 2005 reflects higher sales volume and different product mix.

We cannot be sure that gross margins will remain at current levels or show improvement in the future due to the distribution channels used, product mix, and fluctuation in manufacturing production levels and overhead costs as new products are introduced. In addition, inefficiencies in manufacturing new products and the distribution channels utilized to sell those products may adversely impact gross margin.

Operating Expenses

Selling, general and administrative expenses increased by 26%, or $108,524, to $526,223 for the third quarter and by 12%, or $160,421, to $1,446,665 for the first nine months of fiscal 2005, as compared to $417,699 and $1,286,244, respectively, for the comparable periods in fiscal 2004. For the third quarter of fiscal 2005, rent expense increased as a result of our entering into a lease for new corporate offices and assembly, engineering and manufacturing facility in King of Prussia, Pennsylvania effective May 1, 2005. The increase in selling, general and administrative expenses also reflects one-time expenses, which we incurred in the third quarter of fiscal 2005, in connection with relocating to this facility in late June and early July of 2005. Our future rent expense under this new lease will be greater than our rent expense for the facilities that it replaced.

We incurred professional fees in connection with the merger agreement with Synergetics of approximately $437,000 for the third quarter, and $519,000 for the first nine months, of fiscal 2005. It is expected that we will incur additional professional fees and printing costs in connection with the merger in the fourth quarter of fiscal 2005.

Research and development expenses were $108,307 for the three months, and $454,752 for the nine months, ended June 30, 2005, as compared to $114,754 for the three months, and $355,662 for the nine months, ended June 30, 2004. We will continue to invest in research and development to expand our technological base for use in both existing and additional clinical fields.

Other Income (Expenses)

In the third quarter of fiscal 2005, we realized a gain of $111,674 from the sale of our assembly, engineering and manufacturing in Philadelphia, Pennsylvania by our wholly-owned subsidiary, Diversified Electronics Company, Inc.

In the second quarter of fiscal 2005, we recorded an expense of $150,000 in connection with the lawsuit entitled Jeffrey Turner and Cathryn Turner v.

Phoenix Children's Hospital, Inc. , et al., in which Valley Forge was one of the defendants. In April 2005, without admitting liability in this disputed claim, and as a precondition to Valley Forge's merger agreement with Synergetics, a settlement agreement and release was entered into in which we paid $150,000 towards plaintiff's expenses in the lawsuit.

Income Tax Provision

The provision for income taxes was $890 for the three months, and $105,083 for the nine months, ended June 30, 2005 as compared to $50,583 for the three months, and $116,533 for the nine months, ended June 30, 2004.

Net Income

Net income decreased to $182 for the three months, and $139,066 for the nine months, ended June 30, 2005, as compared to net income of $65,006 for the three months, and $145,564 for the nine months, ended June 30, 2004. Basic and diluted income per share was $0.00 for the three months, and $0.02 for the nine months, ended June 30, 2005 as compared to $0.01 for the three months, and $0.02 for the nine months, ended June 30, 2004.

Liquidity and Capital Resources

At June 30, 2005, we had $3,852,154 in working capital compared to $3,718,481 at September 30, 2004 and $3,746,333 at June 30, 2004. The primary measures of our liquidity are cash, cash equivalents, accounts receivable and inventory balances. The cash equivalents are highly liquid with original maturities of ninety days or less.

Cash used in operating activities was $17,959 for the nine months ended June 30, 2005 as compared to cash used of $78,867 for the nine months ended June 30, 2004. The cash used in operating activities for the first nine months of fiscal 2005 was mainly attributable to an increase in accounts receivable of $295,554 and an increase in inventory of $10,781, partially offset by an increase in accounts payable, accrued expenses and income taxes payable of $227,284.

In the first nine months of fiscal 2005, accounts receivable net of allowances increased by $295,554 to $941,778 at June 30, 2005 from $646,224 at September 30, 2004. The increase in accounts receivable was principally due to increased sales.

In the first nine months of fiscal 2005, inventories increased by $10,781 to $792,385 at June 30, 2005 from $781,604 at September 30, 2004.

The increase in accounts payable reflects increases in material purchases due to increased sales volume and merger related expenses.

For the nine months ended June 30, 2005, our investing activities provided $21,542, which was attributable primarily to the net proceeds of $185,788 we received from the disposition of our manufacturing facility in Philadelphia, Pennsylvania by our wholly-owned subsidiary, Diversified Electronics Company, Inc., net of $171,296 primarily for the purchase of equipment and building improvements in connection with the lease of our new facility in King of Prussia, Pennsylvania. Net property and equipment increased to $221,101 at June 30, 2005 as compared to $147,967 at September 30, 2004.

In the third quarter of fiscal 2005, we entered into a combination sublease and lease, commencing on May 1, 2005, for a term of four and one-half years, for approximately 13,500 square feet of office, assembly, engineering and manufacturing space in King of Prussia, Pennsylvania, with an initial annual rent of $74,858, increasing to $129,437, plus annual operating expenses. In late June and early July 2005, we moved both our Philadelphia, Pennsylvania manufacturing, engineering and assembly facility and our Oaks, Pennsylvania offices into this facility.

In August 2002, our Board of Directors terminated our then existing stock repurchase plan and authorized a new repurchase plan to purchase up to 200,000 shares of our common stock. We did not purchase any of our stock in the third quarter of fiscal 2005 pursuant to this plan. To date, we have repurchased 154,100 shares of our common stock under the plan, leaving a balance of 45,900 that is available for repurchase under the plan.

At June 30, 2005, we had cash and cash equivalents of $2,386,742. We plan to finance our operating and capital needs principally with cash flows from operations and existing balances of cash and cash equivalents, which we believe will be sufficient to fund our operations in the near future. However, should it be necessary, we believe we could borrow adequate funds at competitive rates and terms. Our future liquidity and capital requirements will depend on numerous factors, including the funds we expend in marketing, selling and distributing our products, the success in commercializing our existing products, development and commercialization of products in other clinical markets, the ability of our suppliers to continue to meet our demands at current prices, the status of regulatory approvals and competition.

We have a line of credit of $1,000,000 with Wachovia Bank, N.A. which calls for interest to be charged at the bank's national commercial rate. The credit accommodation is unsecured and requires us to have a tangible net worth of no less than $3,400,000. Our current tangible net worth exceeds $3,400,000 at June 30, 2005. As of June 30, 2005, there was no outstanding balance on this line.

USE OF ESTIMATES AND CRITICAL ACCOUNTING POLICIES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make judgments, assumptions, and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Note 1 to the Consolidated Financial Statements describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements. Estimates are used for, but not limited to, the accounting for the allowance for doubtful accounts and sales returns, inventory allowances, warranty costs, contingencies and other special charges, and taxes. Actual results could differ materially from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions, and estimates used in the preparation of the Consolidated Financial Statements.

Allowances For Doubtful Accounts, Sales Returns and Warranty Costs

We evaluate the collectibility of accounts receivable based on a combination of factors. In circumstances where a specific customer is unable to meet its financial obligations to us, we record an allowance against amounts due

to reduce the net recognized receivable to the amount that we reasonably expect to collect. For all other customers, we record allowances for doubtful accounts based on the length of time the receivables are past due, the current business environment and our historical experience. If the financial condition of customers or the length of time that receivables are past due were to change, we may change the recorded amount of allowances for doubtful accounts in the future. We record a provision for estimated sales returns and allowances on product revenues in the same period as the related revenues are recorded. We base these estimates on historical sales returns and other known factors. Actual returns could be different from our estimates and the related provisions for sales returns and allowances, resulting in future changes to the sales returns and allowances provision. Our warranty obligation is affected primarily by product that does not meet specifications within the applicable warranty period and any related costs to repair or replace such products. Should our actual experience of warranty claims differ from our estimates of such obligations, our provision for warranty costs could change.

Inventories

Inventories, which consist of raw materials, work-in-process and finished goods, and include purchased materials, direct and indirect labor and direct and indirect manufacturing overhead, are stated at the lower of cost, determined by the moving average method, or market. At each balance sheet date, we evaluate inventories for excess quantities and identified obsolescence. Our evaluation includes an analysis of historical sales levels by product and projections of future demand, as well as estimates of quantities required to support warranty and other repairs. To the extent that we determine there are excess quantities based on our projected levels of sales and other requirements, or obsolete material in inventory, we record valuation reserves against all or a portion of the value of the related parts or products. If future demand or market conditions are different than our projections, a change in recorded inventory valuation reserves may be required and would be reflected in cost of sales in the period the revision is made.

Amortization Periods

We record amortization of intangible assets using the straight-line method over the estimated useful lives of these assets. We base the determination of these useful lives on the period over which we expect the related assets to contribute to our cash flows or in the case of patents, their legal life, whichever is shorter. If our assessment of the useful lives of intangible assets changes, we may change future amortization expense.

Deferred Tax Assets and Liabilities

Our deferred tax assets and liabilities are determined based on differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year

in which the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance when a determination is made that it is more likely than not that a portion or all of the deferred tax assets will not be realized.

Loss Contingencies

We may be subject to claims and lawsuits in the ordinary course of our business, including claims by employees or former employees, with respect to our

products and involving commercial disputes. Our financial statements do not reflect any material amounts related to possible unfavorable outcomes of claims and lawsuits, as we are not aware of any such claims or lawsuits. Our financial statements do reflect the settlement of the lawsuit entitled Jeffrey Turner and Cathryn Turner v. Phoenix Children's Hospital, Inc., et al.

Goodwill Impairment

We perform goodwill impairment tests on an annual basis and as needed if events or circumstances indicate that goodwill may have been impaired. In response to changes in industry and market conditions, we may be required to strategically realign our resources and consider restructuring, disposing, or otherwise exiting businesses, which could result in an impairment of goodwill. Impairment is measured by the difference between the recorded value of goodwill and its implied fair value when the fair value of the reporting unit is less than its net book value.

Impairment of Long-Lived Assets

Long-lived assets and certain identifiable intangible assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the group of assets and their eventual disposition. Measurement of an impairment loss for long-lived assets and certain identifiable intangible assets that management expects to hold and use is based on the fair value of the asset. Long-lived assets and certain identifiable intangible assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.

Stock-Based Compensation

We account for stock-based employee compensation using the intrinsic value method of accounting. Under this method, employee stock-based compensation expense is based on the difference, if any, on the date of the grant between the fair value of the Company's stock and the exercise price of the award. We account for stock options issued to non-employees using the fair value method of accounting, which requires us to assign a value to the stock options issued based on an option pricing model, and to record that value as compensation expense. We use the Black-Scholes option pricing model. If we were to account for stock options issued to employees using the fair value method of accounting rather than the intrinsic value method, our results of operations would be significantly affected.

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

The information provided in this Quarterly Report on Form 10-Q contain in addition to historic information, "forward looking" statements or statements which arguably imply or suggest certain things about our future. Statements which express that we "believe", "anticipate", "expect", or "plan to" as well as other statements which are not historical fact, are forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on assumptions that we believe are reasonable, but a number of factors could cause our actual results to differ materially from those expressed or implied by these statements including:

- competitive, regulatory and market conditions;

- the performance of new products and the continued acceptance of current products in the marketplace;
- the execution of strategic initiatives and alliances;
- disruptions caused by moving our assembly, engineering and manufacturing facility;
- the market penetration by third parties who distribute and sell our products;
- our ability to maintain a sufficient supply of products;
- product liability claims;
- the uncertainties associated with intellectual property protection for our products;
- the possibility that the merger transaction with Synergetics will not close or that the closing will be delayed due to the regulatory review or other factors;
- the challenges and costs of combining the operations and personnel of Synergetics with Valley Forge after a closing of the merger agreement;
- the ability to attract and retain highly qualified employees;
- competitive factors, including pricing pressures;
- reactions of customers of Valley Forge and Synergetics and end-users of Valley Forge and Synergetics products to the merger transaction and related risks of maintaining pre-existing relationships of Valley Forge and Synergetics;
- adverse changes in general economic or market conditions;
- other one-time events;
- other important factors disclosed previously and from time to time in Valley Forge's filings with the SEC; and
- other risk factors described in the sections entitled "Factors That Might Affect Future Results" in this report.

Readers are cautioned not to rely on these forward looking statements. We do not intend to update or revise these forward looking statements.

FACTORS THAT MIGHT AFFECT FUTURE RESULTS

We currently rely on our relationship with a single customer for a significant portion of our revenues, which makes our financial position and operating results vulnerable to the loss of that customer.

Our most important relationship is with Codman, an affiliate of Johnson & Johnson, for the sale of our neurosurgery products. Sales to Codman accounted for 85% of our sales for the first nine months of fiscal 2005, 86% of our sales in fiscal year 2004, and 95% and 90% of our sales in fiscal years 2003 and 2002, respectively. Under our agreement with Codman, our exclusive distributorship relationship expired on July 15, 2005. In addition, the agreement will expire on December 31, 2005, or earlier, pursuant to the terms of the agreement.

The impact to us of the expiration of our exclusive relationship with Codman, and the corresponding termination of Codman's minimum purchase obligations under the agreement, is uncertain. If we are unable to establish alternative or additional channels of distribution for our products, we may be unable to achieve the same revenue levels as those that have historically resulted from our relationship with Codman. In addition, any continuation of the distribution agreement with Codman beyond December 31, 2005 could be on terms less favorable than the existing distribution agreement with Codman.

If any of our single source suppliers were to cease providing components, we may not be able to produce our products.

We currently subcontract for the manufacturing of our disposable cord and tubing sets with a single manufacturer. If this supplier becomes unwilling or unable to provide products or components in the required volumes and quality levels or in a timely manner, we would be required to locate and contract with substitute suppliers. Although we believe that alternative sources for many of these components and raw materials are available, we could have difficulty identifying a substitute supplier in a timely manner or on commercially reasonable terms and may have to pay higher prices to obtain the necessary materials. Any supply interruption could harm our ability to manufacture our products until a new source of supply is identified and qualified.

We have also become aware that the manufacturers of several parts used in our currently available bipolar electrosurgical generator models will no longer be manufacturing these parts in the near future. While we have arranged to purchase and maintain a significant inventory of these parts and are developing alternatives for these parts, our efforts may not be sufficient depending on our unit sales. Alternative parts, if available, would require engineering redesign and may require regulatory approval before the manufacture of additional new units. In addition, in the event that we determine to continue the manufacture and sale of the existing product line together with our new multifunctional bipolar electrosurgical generator, such redesign, part sourcing and regulatory approval may also be required.

The medical device industry is highly competitive, and we may be unable to compete effectively with other companies.

The medical technology industry is characterized by intense competition. We compete with established medical technology and early stage companies that have alternative solutions for the markets we serve or intend to serve. Many of our competitors have access to greater financial, technical, research and development, marketing, manufacturing, sales, distribution services and other resources than we do. Further, our competitors may be more effective at implementing their technologies to develop commercial products. Certain of the medical indications that can be treated by our devices can also be treated by other medical devices or by medical practices that do not include a device. The medical community widely accepts many alternative treatments and certain of these treatments have a long history of use.

Our competitive position will depend on our ability to achieve market acceptance for our products, develop new products, implement production and marketing plans, secure regulatory approval for products under development, and protect our intellectual property. We may need to develop new applications for our products to remain competitive. Technological advances by one or more of our current or future competitors could render our present or future products obsolete or uneconomical. Our future success will depend upon our ability to compete effectively against current technology as well as to respond effectively to technological advances.

Our future results are dependent, in part, upon the successful introduction of our new multifunctional bipolar electrosurgical generator.

Our future success, in a large part, may depend upon the successful launch of our new multifunctional bipolar electrosurgical generator and new proprietary single-use, hand-switching bipolar instruments. While we believe that this new generator and related instruments represent significant advancements in technology and performance and will replace other surgical tools in certain applications, such as monopolar electrosurgical systems and lasers, their

success in the marketplace is dependent upon several factors including:

- the completion of the design and testing;
- their acceptance by surgeons;
- the recognition by hospitals and surgical centers that the new generator and instruments are sufficiently improved and beneficial to warrant the cost of acquisition and training;
- our ability to create a sales network;
- our ability to sustain our average selling price through this network; and
- the reaction of our competitors in this market.

Our products may not be accepted in the market.

We cannot be certain that our current products or any other products that we may develop or market will achieve or maintain market acceptance. We cannot be certain that our devices and procedures they perform will be able to replace those established treatments or that either physicians or the medical community in general will accept and utilize our devices or any other medical

products that we may develop. For example, we cannot be certain that the medical community will accept our new multifunctional electrosurgical generator and proprietary hand-switching bipolar electrosurgical instruments over traditional monopolar electrosurgical generators.

Market acceptance of our products depends on many factors, including our ability to convince third party distributors and customers that our technology is an attractive alternative to other technologies, to manufacture products in sufficient quantities and at acceptable costs, and to supply and service sufficient quantities of our products directly or through our distribution alliances.

If we do not introduce new commercially successful products in a timely manner, our products may become obsolete over time, thereby decreasing our revenue and profitability.

Demand for our products may change because of evolving customer needs, the introduction of new products and technologies, the discovery of cures for certain medical problems, evolving surgical practices and evolving industry standards. Without the timely introduction of new commercially successful products and enhancements, our products may become obsolete over time, causing our sales and operating results to suffer. The success of our new products will depend on several factors, including our ability to:

- properly identify and anticipate customer needs;
- commercialize new products in a cost-effective and timely manner;
- manufacture and deliver products in sufficient volumes on time;
- obtain regulatory approval for new products;
- differentiate our products from those of competitors;
- achieve positive clinical outcomes;
- satisfy the increased demands by health care payors, providers and patients for lower-cost procedures and shorter hospital stays and recovery times;
- innovate and develop new materials, product designs and surgical techniques; and
- provide adequate medical and/or customer education relating to new products and attract key surgeons to advocate these new products.

New products and enhancements usually require a substantial investment in research and development before we can determine the viability of the product, and we may not have the financial resources necessary to fund this research and development. Moreover, new products and enhancements may not produce revenues in excess of the research and development costs, and they may be quickly obsolete by changing customer preferences or the introduction by our competitors of new technologies or features.

Our operating results may fluctuate.

We have experienced operating losses at various times since our inception. Our operating results, including components of operating results, such as gross margin on product sales, may fluctuate from time-to-time which could affect our stock price. Our operating results have fluctuated in the past and can be expected to fluctuate from time-to-time in the future. Some of the factors that may cause these fluctuations include, but are not limited to:

- the introduction of new product lines;
- product modifications;
- the level of market acceptance of our products;
- the timing of research and development expenditures;
- timing of the receipt of orders from, and product shipments to, distributors and customers;
- timing of expenditures;
- changes in the distribution arrangements for our products;
- manufacturing or supply delays;
- the time needed to educate and train a distributor's sales force;
- costs associated with product introduction;
- product returns; and
- receipt of necessary regulation approvals.

Changes in the health care industry may require us to decrease the selling price for our products or could result in a reduction in the size of the market for our products, each of which could have a negative impact on our financial performance.

Trends toward managed care, health care cost containment, and other changes in government and private sector initiatives in the United States and other countries in which we do business are placing increased emphasis on the delivery of more cost-effective medical therapies that could adversely affect the sale or the prices of our products. For example:

- there has been a consolidation among health care facilities and purchasers of medical devices in the United States who prefer to limit the number of suppliers from whom they purchase medical products, and these entities may decide to stop purchasing our products or demand discounts on our prices;
- major third-party payors of hospital services, including Medicare, Medicaid and private health care insurers, have substantially revised their payment methodologies, which has resulted in stricter standards for reimbursement of hospital charges for certain medical procedures;
- Medicare, Medicaid and private health care insurer cutbacks could create downward price pressure on our products;
- numerous legislative proposals have been considered that would result in major reforms in the U.S. health care system that could have an adverse effect on our business;
- there is economic pressure to contain health care costs in international markets; and

- there have been initiatives by third-party payors to challenge the prices charged for medical products that could affect our ability to sell products on a competitive basis.

Both the pressures to reduce prices for our products in response to these trends and the decrease in the size of the market as a result of these trends could adversely affect our levels of revenues and profitability of sales.

We will first need regulatory approval to market our products under development. We may be subject to penalties and may be precluded from marketing our products if we fail To comply with extensive governmental regulations.

Our research and development activities and the manufacturing, labeling, distribution and marketing of our existing and future products are subject to regulation by numerous governmental agencies in the United States and in other countries. The Food and Drug Administration (FDA) and comparable agencies in other countries impose mandatory procedures and standards for the conduct of clinical trials and the production and marketing of products for diagnostic and human therapeutic use.

Products we have under development are subject to FDA approval or clearance prior to marketing for commercial use. The process of obtaining necessary FDA approvals or clearances can take years and is expensive and full of uncertainties. Our inability to obtain required regulatory approval or clearance on a timely or acceptable basis could harm our business. Further, approval or clearance may place substantial restrictions on the indications for which the product may be marketed or to whom it may be marketed. Further studies may be required to gain approval or clearance for the use of a product for clinical indications other than those for which the product was initially approved or cleared or for significant changes to the product.

Furthermore, another risk of application to the FDA relates to the regulatory classification of new products or proposed new uses for existing products. In the filing of each application, we are required to make a judgment about the appropriate form and content of the application. If the FDA disagrees with our judgment in any particular case and, for example, requires us to file a premarket approval (PMA) application rather than allowing us to market for approved uses while we seek broader approvals or requires extensive additional clinical data, the time and expense required to obtain the required approval might be significantly increased or approval might not be granted. Approved and cleared products are subject to continuing FDA requirements relating to quality control and quality assurance, maintenance of records, reporting of adverse events and product recalls, documentation, and labeling and promotion of medical devices.

The FDA as well as foreign regulatory authorities require that our products be manufactured according to rigorous standards. These regulatory requirements may significantly increase our production costs and may even prevent us from making our products in amounts sufficient to meet market demand. If we change our approved manufacturing process, the FDA may need to review the process before it may be used. Failure to develop our manufacturing capability may mean that even if we develop promising new products, we may not be able to produce them profitably, as a result of delays and additional capital investment costs. In addition, failure to comply with applicable regulatory requirements could subject us to enforcement action, including product seizures, recalls, withdrawal of clearances or approvals, restrictions on or injunctions against marketing our product or products based on our technology, and civil and criminal penalties.

Our intellectual property rights may not provide meaningful commercial protection for our products and could adversely affect our ability to compete in the market.

Our ability to compete effectively depends in part, on our ability to maintain the proprietary nature of our technologies and manufacturing processes, which includes the ability to obtain, protect and enforce patents on our technology and to protect our trade secrets. We own patents that cover significant aspects of our products. Certain of our patents have expired and others will expire in the future. In addition, challenges may be made to our patents and, as a result, our patents could be narrowed, invalidated or rendered unenforceable. Competitors may develop products similar to ours that our patents do not cover. In addition, our current and future patent applications may not result in the issuance of patents in the United States or foreign countries. Further, there is a substantial backlog of patent applications at the U.S. Patent and Trademark Office, and the approval or rejection of patent applications may take several years. We may become subject to patent infringement claims or litigation or interference proceedings declared by the U.S. Patent and Trademark Office to determine the priority of inventions.

Our competitive position depends, in part, upon unpatented trade secrets, which are difficult to protect. Others may independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets. In an effort to protect our trade secrets, we generally require certain of our employees, consultants and advisors to execute proprietary information and invention assignment agreements upon commencement of employment or consulting relationships with us. These agreements typically provide that, except in specified circumstances, all confidential information developed or made known to the individual during the course of their relationship with us must be kept confidential. Some jurisdictions limit the enforceability and scope of these agreements and these agreements may not provide meaningful protection for our trade secrets or other proprietary information in the event of the unauthorized use or disclosure of confidential information.

We may have product liability claims and our insurance may not cover all claims.

Our products involve a risk of product liability claims. We may not be able to obtain insurance for the potential liability on acceptable terms with adequate coverage or at reasonable costs. Any potential product liability claims could exceed the amount of our insurance coverage or may be excluded from coverage under the terms of the policy. Further, our insurance may not be renewed at a cost and level of coverage comparable to that then in effect.

The market price of our stock may be highly volatile.

During the first nine months of fiscal 2005 and during fiscal 2004 and 2003, our common stock has traded in a range of $1.05 and $5.25 per share. The market price of our common stock could continue to fluctuate substantially due to a variety of factors, including:

- our ability to successfully commercialize our products;

- the execution of new agreements and material changes in our relationships with companies with whom we contract;
- quarterly fluctuations in results of operations;
- announcements regarding technological innovations or new commercial products by us or our competitors or the results of regulatory approval filings;
- market reaction to trends in sales, marketing and research and development and reaction to acquisitions;
- sales of common stock by existing stockholders;
- economic and political conditions; and
- fluctuations in the United States financial markets.

Historically, the trading volume for our common stock has been limited.

Our common stock is thinly traded in comparison to companies with greater market capitalization. As a result, large sell trades, negative news and general economic pressures on the stock market can have an impact on the price of our common stock that is more pronounced than securities of other issuers with larger listed stock volume or higher prices per share. Further, our common stock has a limited float. A large percentage of our outstanding common stock is held by management and insiders, so the float is limited and the stock is much less liquid.

The loss of key personnel could harm our business.

We believe our success depends on the contributions of a number of our key personnel, including Jerry L. Malis, our President and Chief Executive Officer. If we lose the services of key personnel, those losses could materially harm our business. We do not maintain any significant key person life insurance on Mr. Malis.

Item 4. CONTROLS AND PROCEDURES

Our management, including our Chief Executive Officer/Principal Financial Officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures as of June 30, 2005. Based on that evaluation, our management, including our Chief Executive Officer/Principal Financial Officer, has concluded that our disclosure controls and procedures are effective. During the period covered by this report, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

In April 2005, without admitting liability and as a precondition to Valley Forge's merger agreement with Synergetics, Inc., Valley Forge settled the lawsuit entitled Jeffrey Turner and Cathryn Turner v. Phoenix Children's Hospital, Inc. , et al., in which Valley Forge was one of the defendants, and paid $150,000 towards plaintiff's expenses in the lawsuit.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit 2.1	Agreement and Plan of Merger by and among Valley Forge Scientitific Corp., Synergetics Acquisition

	Corporation and Synergetics, Inc. dated May 2, 2005. (1)
Exhibit 2.2	Amendment No. 1 to Agreement and Plan of Merger by and among Valley Forge Scientitific Corp., Synergetics Acquisition Corporation and Synergetics, Inc. dated June 2, 2005. (2)
Exhibit 2.3	Amendment No. 2 to Agreement and Plan of Merger by and among Valley Forge Scientitific Corp., Synergetics Acquisition Corporation and Synergetics, Inc. dated July 15, 2005. (3)
Exhibit 9.1	Valley Forge Voting Agreement among certain shareholders of Valley Forge Scientific Corp., Valley Forge Scientific Corp. and Synergetics, Inc. dated May 2, 2005. (1)
Exhibit 9.2	Synergetics Voting Agreement among certain shareholders of Synergetics, Inc., Valley Forge Scientific Corp. and Synergetics, Inc. dated May 2, 2005. (1)
Exhibit 10.16	Agreement and Lease between Liberty Property Limited Partnership and Valley Forge Scientific Corp. (4)
Exhibit 10.17	Agreement for Sale of Commercial Real Estate between Diversified Electronics Company, Inc. and Stan Smith dated April 21, 2005. (4)
Exhibit 31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.1	Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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(1) Previously filed with Valley Forge's Current Report on Form 8-K filed on May 4, 2005 and incorporated herein by reference.
(2) Previously filed with Valley Forge's Current Report on Form 8-K filed on June 3, 2005 and incorporated herein by reference.
(3) Previously filed with Valley Forge's Current Report on Form 8-K filed on July 15, 2005 and incorporated herein by reference.
(4) Previously filed with Valley Forge's Form S- 4 Registration Statement (Registration No. 333-125521) and incorporated herein by reference.

(b) Current Reports on Form 8-K

On May 4, 2005, Valley Forge Scientific Corp. filed a report on Form 8-K regarding a merger agreement with Synergetics, Inc.

On May 11, 2005, Valley Forge Scientific Corp. filed a report on Form 8-K regarding an amendment to an agreement with Codman & Shurtleff, Inc.

On May 13, 2005, Valley Forge Scientific Corp. filed a report on Form 8-K regarding its results of operations.

On May 24, 2005, Valley Forge Scientific Corp. filed a report regarding a determination by The Nasdaq Stock Market that the merger with Synergetics, Inc. constitutes a "reverse merger."

On June 3, 2005, Valley Forge Scientific Corp. filed a report on Form 8-K regarding an amendment to the merger agreement with Synergetics, Inc.

Subsequent to the end of the quarter, on July 15, 2005, Valley Forge Scientific Corp. filed a report on Form 8-K regarding an amendment to the merger agreement with Synergetics, Inc.

Subsequent to the end of the quarter, on August 11, 2005, Valley Forge Scientific Corp. filed a report on Form 8-K regarding its results of operations.

VALLEY FORGE SCIENTIFIC CORP.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VALLEY FORGE SCIENTIFIC CORP.

Date: August 15, 2005

By: /s/ JERRY L. MALIS
Jerry L. Malis, President and
Chief Executive Officer
(principal financial officer)

VALLEY FORGE SCIENTIFIC CORP.
For Quarterly Period Ended June 30, 2005
FORM 10-Q
EXHIBIT INDEX

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