VALLEY FORGE SCIENTIFIC CORP
Form 10-Q
May 16, 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 March 31, 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.)

136 Green Tree Road, Oaks, Pennsylvania 19456
(Address of principal executive offices and zip code)

Telephone: (610) 666-7500

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 May 10, 2005 there were 7,913,712 shares outstanding of the Registrant's no par value Common Stock.

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VALLEY FORGE SCIENTIFIC CORP.

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March 31, 2005

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	March 31, 2005 (Unaudited)	September 30, 2004 (Audited)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 2,647,334	$ 2,322,559
Accounts receivable - net	837,704	646,224
Inventory	736,115	781,604
Loans receivable - stockholder/officer	14,100	41,792
Prepaid items and other current assets	185,175	104,619
Deferred tax assets	79,232	79,752
Total Current Assets	4,499,660	3,976,550
Property, plant and equipment - net	180,952	147,967

Goodwill	153,616	153,616
Intangible assets - net	198,050	218,398
Loans receivable - stockholder/officer	25,259	--
Other assets	3,480	26,707
Total Assets	$ 5,061,017	$ 4,523,238
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and accrued expenses	$ 610,356	$ 245,828
Income taxes payable	47,038	6,491
Deferred revenue	--	5,750
Total Current Liabilities	657,394	258,069
Deferred Tax Liability	15,313	15,743
Total Liabilities	672,707	273,812
Contingencies		
Stockholders' Equity:		
Preferred stock	--	--
Common stock (no par, 20,000,000 shares authorized, shares issued and outstanding at March 31, 2005 and September 30, 2004 - 7,913,712)	3,528,530	3,528,530
Retained earnings	859,780	720,896
Total Stockholders' Equity	4,388,310	4,249,426
Total Liabilities and Stockholders' Equity	$ 5,061,017	$ 4,523,238

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended March 31,		For the S M
	2005	2004	2005
Net Sales	$ 1,816,029	$ 1,132,771	$ 3,228,40
Cost of Sales	834,660	511,864	1,482,78
Gross Profit	981,369	620,907	1,745,62

Other Costs:			
Selling, general and administrative	490,028	470,208	920,44
Merger related professional fees	71,946	--	82,23
Research and development	138,750	127,013	346,44
Amortization	10,174	10,074	20,34
Total Other Costs	710,898	607,295	1,369,47
Income from Operations	270,471	13,612	376,15
Other Income (Expense)			
Settlement of lawsuit	(150,000)	--	(150,00
Interest income	8,818	5,369	16,92
Total Other Income (Expense)	(141,182)	5,369	(133,07
Income before Income Taxes	129,289	18,981	243,07
Provision for Income Taxes	58,826	11,402	104,19
Net Income	$ 70,463	$ 7,579	$ 138,88
Income per Share:			
Basic income per common share	$ 0.01	$ 0.00	$ 0.0
Diluted income per common share	$ 0.01	$ 0.00	$ 0.0
Basic weighted average common shares outstanding	7,913,712	7,913,712	7,913,71
Diluted weighted average common shares outstanding	7,956,915	7,977,448	7,967,04

See accompanying notes to consolidated financial statements.

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

	For the Six Months Ended March 31,	
	2005	2004
Cash Flows from Operating Activities:		
Net income	$ 138,884	$ 80,558
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	35,415	35,194
Interest accrued on loans and advances to employees and related parties	(1,092)	(1,167)

Deferred income taxes	90	(15,549)
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(191,480)	(272,061)
Inventory	45,489	9,497
Prepaid items and other current assets	(80,485)	54,398
Other assets	8,827	8,828
Increase (decrease) in:		
Accounts payable and accrued expenses and income taxes payable	405,075	63,356
Deferred revenue	(5,750)	17,250
Net cash provided by operating activities	354,973	(19,696)
Cash Flows from Investing Activities:		
Purchases of property, plant and equipment	(33,723)	(9,842)
Proceeds from repayments of loans to stockholder	3,525	5,000
Net cash (used in) investing activities	(30,198)	(4,842)
Net Change in Cash and Cash Equivalents	324,775	(24,538)
Cash and Cash Equivalents - Beginning of Period	2,322,559	2,305,556
Cash and Cash Equivalents - End of Period	$ 2,647,334	$ 2,281,018
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	$ 65,356	$ 2,000
Interest	--	--

See accompanying notes to consolidated financial statements.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
MARCH 31, 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 six months ended March 31, 2005, are not necessarily indicative of results for the full year.

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.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
MARCH 31, 2005

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 March 31,		Six Months Ended March 31,	
	2005	2004	2005	2004
Net income - as reported	$ 70,463	$ 7,579	$ 138,884	$ 80,558
Less: total compensation expense determined under fair value based method - net of tax effect	18,586	45,142	18,586	45,142
Pro Forma Net Income (Loss)	$ 51,877	$ (37,563)	$ 120,298	$ 35,416
Pro Forma Income (Loss) Per Share:				
Basic	$ 0.01	$ 0.00	$ 0.02	$ 0.00
Diluted	$ 0.01	$ 0.00	$ 0.02	$ 0.00

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)
MARCH 31, 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. The agreement provided for worldwide exclusive distribution rights of neurosurgery products during the term. This distribution agreement included minimum purchase obligations which were adjusted annually during the term of the agreement. It also included a price list for the specified products, which was fixed for a period of time, after which those prices were subject to adjustment by the Company due to changes in manufacturing cost or technological improvements to the products. On October 15, 2004, the Company executed a new agreement with Codman for the period October 1, 2004 through December 31, 2005. The agreement provided for exclusive worldwide distribution rights of the Company's existing neurosurgery products in the fields of neurocranial and neurospinal surgery until March 31, 2005, and non-exclusive rights in these fields from April 1, 2005 through December 31, 2005. As of March 1, 2005 and on May 6, 2005, the agreement was amended extending the period of exclusivity through July 15, 2005. The agreement, as amended, also includes a price list for the specified products, and a minimum purchase obligation of $1,000,000 per calendar quarter, through July 15, 2005. There is no minimum purchase obligation for the period July 15, 2005 through December 31, 2005. The agreement also provides that the above-indicated periods of exclusive and nonexclusive distribution rights can each be extended by mutual consent of the parties. Codman did not satisfy its minimum purchase requirements for the three months ended December 31, 2004 but did make up the deficiency by increasing its purchases in the three months ended March 31, 2005.

Sales to Codman amounted to approximately $1,254,000 and $2,190,000 for the three and six months ended March 31, 2005 and $975,000 and $2,001,000 for the three and six months ended March 31, 2004, respectively. This represented 69%, 68%, 86% and 86% of net sales for the respective periods.

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.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

MARCH 31, 2005

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.

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.

Sales to Stryker for the three and six months ended March 31, 2005 amounted to approximately $413,000 and $788,000, respectively. This represented 23% and 24% of net sales for the respective periods.

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 $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 and would be paid with an initial payment of $159,904 and the execution of a note payable to Dr. Malis for $3,997,600, including interest. 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.

NOTE 5 - SUPPLEMENTAL BALANCE SHEET INFORMATION:

Accounts Receivable - Net

	2005	2004

	(Unaudited)	(Audited)
Accounts receivable	$ 853,184	$ 661,704
Less: Allowances	15,480	15,480
Accounts receivable - net	$ 837,704	$ 646,224

Inventory

	March 31, 2005	September 30, 2004
	(Unaudited)	(Audited)
Finished goods	$ 106,945	$ 94,405
Work-in-process	215,449	396,810
Materials and parts	559,777	424,052
	882,171	915,267
Less: Allowances for slow moving and obsolete inventory	146,056	133,663
	$ 736,115	$ 781,604

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
MARCH 31, 2005

NOTE 5 - SUPPLEMENTAL BALANCE SHEET INFORMATION (CONTINUED):

Property, Plant and Equipment - Net

	Useful Life (Years)	March 31, 2005	September 30, 2004
		(Unaudited)	(Audited)
Land	--	$ 11,953	$ 11,953
Buildings and improvements	15 - 39	103,467	103,467
Furniture and fixtures	5 - 7	17,953	17,953
Laboratory equipment	5 - 10	422,344	378,159
Office equipment	5	186,762	185,530
Leasehold improvements	3 - 5	12,118	9,413
		754,597	706,475
Less: Accumulated depreciation and amortization		573,645	558,508
		$ 180,952	$ 147,967

Depreciation amounted to $7,354 and $7,388 for the three months ended March 31, 2005 and 2004, respectively, and $14,846 and $15,045 for the six months ended March 31, 2005 and 2004, respectively.

VALLEY FORGE SCIENTIFIC CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
MARCH 31, 2005

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 March 31, 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:

	March 31, 2005 (Unaudited)			September 30, 2004 (Au	
	Gross Carrying Value	Accumulated Amortization	Net	Gross Carrying Value	Accumulated Amortization
Patents, trademarks and licensing agreements	$ 573,804	$ 506,312	$ 67,492	$ 573,804	$ 503,678
Proprietary know-how	452,354	311,622	140,732	452,354	304,082
Acquisition costs	55,969	55,969	--	55,969	55,969
	$1,082,127	$ 873,903	$ 208,224	$1,082,127	$ 863,729

Amortization expense of intangible assets amounted to $10,174 and $10,074 for the three months ended March 31, 2005 and 2004, respectively, and $20,348 and $20,149 for the six months ended March 31, 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)
MARCH 31, 2005

NOTE 6 - RELATED PARTY TRANSACTIONS:

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 March 31, 2005, loans receivable -

stockholder amounted to $39,359.

Loans receivable - stockholder/officer are partially secured by 5,833 shares of the Company's common stock. At March 31, 2005, the pledged common stock has a value of $7,933.

Operating Lease

The Company is leasing 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 Francis W. Gilloway Marital Trust. The lease expires in June 2005. Rent expense amounted to $15,467 and $30,934 for three and six months ended March 31, 2005, respectively, and $15,017 and $30,033 for the three and six months ended March 31, 2004, respectively. At March 31, 2005, the Company was current on all rent obligations to the related entity.

NOTE 7 - CONTINGENCIES:

Lawsuit

On September 19, 2002, the Company was served with a complaint that was filed in the Superior Court of the State of Arizona, County of Maricopa, entitled Jeffrey Turner and Cathryn Turner et al v. Phoenix Children's Hospital, Inc., et al, (CV 2002-010791) in which the Company was named as one of the defendants. The plaintiffs were seeking damages from all defendants for permanent brain damage suffered by a four-year old girl during a surgery that took place in June 2000. The alleged damages sought by the plaintiffs against all parties were in excess of the Company's product liability insurance policy limit of $1,000,000, and the Company's net worth. The claim against the Company is a products liability claim. The Company's product liability insurance carrier is providing the Company's defense in this matter. This insurance coverage has a $10,000 deductible that applies to attorney fees and damages, which had been provided for in other costs under selling, general and administrative expense for the year ended September 30, 2002.

NOTE 7 - CONTINGENCIES (CONTINUED):

Lawsuit (continued)

In April 2005, this action was settled, subject to court approval, whereby the Company, its insurance carrier and the plaintiffs executed a Settlement Agreement and Release (the "Settlement"). As part of the Settlement, the Company, without admitting liability, agreed to pay the plaintiff $150,000 whereby the Company was completely released and discharged from any past, present or future claim resulting from this matter. Such amount has been accrued and is reflected as an other cost in the statement of income and as accounts payable and accrued expenses in the balance sheet.

Lease

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 Upper Merion Township, Pennsylvania, with an initial annual rental of $74,858, increasing to $129,437, plus annual operating expenses.

NOTE 8 - EARNINGS PER SHARE:

	Three Months Ended March 31,		Six Months Ended March 31,	
	2005	2004	2005	2004
Income available to common stockholders	$ 70,463	$ 7,579	$ 138,884	$ 80,558
Weighted average common shares outstanding - basic	7,913,712	7,913,712	7,913,712	7,913,712
Net effect of dilutive shares issuable in connection with stock plans	43,203	63,736	53,336	58,010
Weighted average common shares outstanding - diluted	$7,956,915	$7,977,448	$7,967,048	$7,971,722
Earnings Per Share:				
Basic	$ 0.01	$ 0.00	$ 0.02	$ 0.01
Diluted	$ 0.01	$ 0.00	$ 0.02	$ 0.01

NOTE 8 - EARNINGS PER SHARE (CONTINUED):

Options to purchase 447,500 and 507,250 shares of common stock were outstanding on March 31, 2005 and 2004, respectively. Of these shares, 404,297 and 443,514 shares were not included in the computation of diluted earnings per share for the three months ended March 31, 2005 and 2004, and 394,164 and 449,240 of these shares were not included in the computation of diluted earnings per share for the six months ended March 31, 2005 and 2004, respectively, in accordance with SFAS 128, as the issuance prices were in excess of the average market price for the period.

NOTE 9 - SUBSEQUENT EVENT

The Company entered into an agreement to sell all of the property and certain equipment of DEC, subject to certain contingencies, for $200,000. The estimated income to be recognized by the Company is approximately $120,000, before moving costs, closing costs and taxes.

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 periods ended March 31, 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 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, which is anticipated to be introduced in the market in fiscal 2005, 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 to be filed with the Securities and Exchange Commission, 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. 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. On May 6, 2005, in accordance with the terms of the amendment, we notified Codman that effective July 15, 2005, Codman would be the nonexclusive worldwide distributor of our existing products in the fields of neurocranial and neurospinal surgery until December 31, 2005. Prior to July 15, 2005, Codman will continue to be the exclusive worldwide distributor of our existing products in those fields. Historically, we have derived a significant portion of our sales from sales to Codman. For the three and six months ended March 31, 2005, 69% and 68%, 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.

Strategy

Our goal is to be the global leader in the development of bipolar medical devices and other products in specialty surgical and healthcare fields. The key elements of our strategy include:

- Expanding the use of our new multifunctional bipolar electrosurgical system into other surgical markets, such as, maxillofacial, ENT, orthopedic and general surgery.
- Increasing revenues in the neurosurgery field with our new multifunctional bipolar electrosurgical system.
- Expanding our product lines with new products and other applications of our bipolar lesion technology.

Results of Operations

Results of Operations for the Three and Six Months Ended March 31, 2005 compared to the Three and Six Months Ended March 31, 2004.

Summary

Sales of $1,816,029, for three months, and $3,228,405 for the six months, ended March 31, 2005 were 60% and 38% greater, respectively, than sales of $1,132,771 and $2,332,240, respectively, for the three and six months ended March 31, 2004. Operating income was $270,471 for the three months, and $376,153 for the six months, ended March 31, 2005 as compared to operating income of $13,612 and $135,470, respectively, for the corresponding periods in fiscal 2004. Net income for the three months ended March 31, 2005 was $70,463 and $138,884 for the six months end March 31, 2005, as compared to net income of $7,579 and $80,558, respectively, for the corresponding periods in fiscal 2004.

Sales

Total Sales and Gross Profit on Sales:

	Unaudited Three Months Ended March 31,		Unaudited Six Months Ended March 31,	
	2005	2004	2005	2004
Total sales:	$1,816,029	$1,132,771	$3,228,405	$2,332,240
Cost of sales:	834,660	511,864	1,482,781	1,067,168
Gross profit on sales:	981,369	620,907	1,745,624	1,265,072
Gross profit as a percentage of sales:	54%	55%	54%	54

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

For the second quarter of fiscal 2005, sales to Codman accounted for 69% of our sales and sales to Stryker accounted for 23% of our sales, as compared to 86% and 1%, of our sales, respectively, for the second quarter of fiscal 2004. For the first six months of fiscal 2005, sales to Codman accounted for 68% of our sales and sales to Stryker accounted for 24% of our sales, as compared to 86% and 1% of our sales, respectively, for the first six months of fiscal 2004.

During the second quarter and first six months of fiscal 2005, we had sales to Stryker Corporation of $413,020 and $788,049, respectively, pursuant to a supply and distribution agreement we entered into on October 25, 2004. There was $15,000 in sales of this product during the second quarter of fiscal 2004. The supply and distribution agreement is for a term commencing on November 11, 2004 and ending on March 31, 2009, under which Stryker has agreed to make minimum purchases of approximately $900,000 in the first agreement year for a combination of sales demonstration units and commercial sale units and minimum purchases of approximately $500,000 per year for commercial sale units in the each of the second and third agreement years. Minimum purchase requirements for agreement years four and five are to be determined by the parties based on market conditions and other factors. The agreement also provides Stryker certain

rights for other new product concepts developed by Valley Forge in both pain control and expanded market areas. As we are already approaching the minimum sales levels for the first agreement year, we anticipate lower levels of sales to Stryker in the third and fourth quarters of fiscal 2005.

Sales of our neurosurgical products and related services to Codman & Shurtleff, Inc. increased to $1,254,363 for the three months, and $2,190,132 for the six months, ended March 31, 2005 as compared to sales of $975,012 for the three months, and $2,000,977 for the six months, ended March 31, 2004. Under an agreement we entered into with Codman, as amended, Codman will continue to be the exclusive worldwide distributor of our existing products in the fields of neurocranial and neurospinal surgery through July 15, 2005, and for the period from July 15, 2005 to December 31, 2005, Codman will be a nonexclusive distributor of our existing products in those fields. For the period from October 1, 2004 to July 15, 2005, Codman has agreed to make minimum purchases of $1 million per calendar quarter in order to maintain its exclusivity. Codman did not satisfy its minimum purchase requirements for the three months ended December 31, 2004, but made up this deficiency in purchase obligations by increasing its purchases in the second quarter of 2005.

For the three and six months ended March 31, 2005, sales of the Bident(R) Bipolar Tissue Management System for dental applications were $143,980 and $219,170, respectively, or 8% and 7% of sales, respectively, as compared to $118,817, or 11% of sales, and $288,867, or 12% 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 six months ended March 31, 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 March 31,		For the Six Months Ended March 31,	
	2005	2004	2005	2004
Generators, Irrigators and Other Products				
Neurosurgery field	$ 733,174	$ 441,235	$1,214,199	$1,048,626
Dental field	125,767	104,590	187,276	256,630
Pain Control fields	412,500	15,000	787,500	15,000
Total of all fields:	$1,271,441	$ 560,825	$2,188,975	$1,320,256
Disposable Products				
Neurosurgery field	$ 450,296	$ 433,139	$ 862,106	$ 804,724
Dental field	18,213	14,227	29,532	32,237
Other fields	2,716	25,426	13,236	28,285

Total of all fields:	$ 471,225	$ 472,792	$ 904,874	$ 865,246

For the second quarter of fiscal 2005, 70% of our sales related to sales of bipolar electrosurgical generators, irrigators and accessories as compared to approximately 45% of our sales for the second quarter of fiscal 2004. Sales of disposable products accounted for approximately 26% of our sales in the second quarter of fiscal 2005 as compared to approximately 44% of our sales in the second quarter of fiscal 2004.

For the first six months of fiscal 2005, 68% of our sales related to sales of bipolar electrosurgical generators, irrigators and accessories as compared to approximately 52% of our sales for the first six months of fiscal 2004. Sales of disposable products accounted for approximately 28% of our sales in the first six months of fiscal 2005, as compared to approximately 40% of our sales in the first six months of fiscal 2004.

Cost of Sales

Cost of sales was 46% of sales for both the three and six months ended March 31, 2005 as compared to 45% of sales for the three months, and 46% of sales of the six months, ended March 31, 2004. Gross margin was 54% for both the three and six months ended March 31, 2005 as compared to 55% for the three months and 54% for the six months ended March 31, 2004. The higher gross margin for the three months ended March 31, 2004, reflects a payment by Codman of $57,938 to satisfy its minimum purchase obligations under the terms of a then existing distribution agreement.

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 were $490,028, or 27 percent of sales, for the second quarter of fiscal 2005 as compared to $470,208, or 41 percent of sales, for the second quarter of fiscal 2004. For the first six months of fiscal 2005, selling, general and administrative expenses were $920,442, or 29 percent of sales, as compared to $868,545, or 37 percent of sales, for the first six months of fiscal 2004. As further described in the "Liquidity and Capital Resources" section below, we expect to incur moving and other one-time expenses, as well as increased rent expenses, in connection with moving our corporate offices, assembly, engineering and manufacturing operations into a single facility during the third and fourth quarters of fiscal 2005.

We incurred professional fees in connection with the merger agreement with Synergetics, Inc., which was entered into on May 2, 2005, of approximately $72,000, for the second quarter of fiscal 2005, and approximately $82,000 for the first six months of fiscal 2005. It is expected that these fees will increase in the third and fourth quarters of fiscal 2005, as additional professional fees and printing costs are incurred in connection with the merger.

Research and development expenses were $138,750, or 8% of sales, and $346,445, or 11% of sales, respectively, for the three and six months ended

March 31, 2005 as compared to $127,013, or 11% of sales, and $240,908, or 10% of sales, for the corresponding period in fiscal 2004. We will continue to invest in research and development to expand our technological base for use in both existing and additional clinical fields. Research and development expenses in the second quarter and first six months of fiscal 2005 reflected the continued development of our new multifunction bipolar electrosurgical generator and instrumentation. In addition, research and development expenses for the six months of fiscal 2005 reflect the completion of the lesion generator model, currently being sold to Stryker.

Other Income (Expenses)

In the second quarter of fiscal 2005, we recorded an expense of $150,000 , or approximately $.02 per share, 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. As described in the "Liquidity and Capital Resources" section below, a settlement agreement was entered into in April 2005. As a result of the foregoing, we had other expenses of $141,182, net of investment income, in the three months, and $133,076, net of investment income, in the six months, ended March 31, 2005 as compared to investment income of $5,369 for the three months, and $11,038 for the six months, ended March 31, 2004.

Income Tax Provision

The provision for income taxes was $58,826 for the three months, and $104,193 for the six months, ended March 31, 2005 as compared to $11,402 for the three months, and $65,950 for the six months, ended March 31, 2004.

Net Income

Net income increased to $70,463 for the three months, and $138,884 for the six months, ended March 31, 2005, as compared to net income of $7,579 for the three months, and $80,558 for the six months, ended March 31, 2004. Basic and diluted income per share was $0.01 for the three months, and $0.02 for the six months, ended March 31, 2005 as compared to $0.00 for the three months, and $0.01 for the six months, ended March 31, 2004.

Liquidity and Capital Resources

At March 31, 2005, we had $3,842,266 in working capital compared to $3,718,481 at September 30, 2004 and $3,673,383 at March 31, 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 provided by operating activities was $354,973 for the six months ended March 31, 2005 as compared to cash used of $19,696 for the six months ended March 31, 2004. The cash provided by operating activities was mainly attributable to operating profits net of adjustments for non-cash items, an increase in accounts payable of $405,075, and a decrease in inventory of $45,489, partially offset by an increase in accounts receivable of $191,480 and an increase in prepaid items and other current assets of $80,485.

In the first six months of fiscal 2005, accounts receivable net of allowances increased by $191,480 to $837,704 at March 31, 2005 from $646,224 at September 30, 2004. The increase in accounts receivable was principally due to increased sales.

In the first six months of fiscal 2005, inventories decreased by $45,489 to $736,115 at March 31, 2005 from $781,604 at September 30, 2004. The decrease was primarily due to improved inventory management and increased sales.

The increase in accounts payable for the first six months of fiscal 2005 reflects our recording 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, Inc., a settlement agreement and release was entered into, subject to court approval, in which we agreed to pay $150,000 towards plaintiff's expenses incurred in the lawsuit. The increase in accounts payable also reflects increases in material purchases due to increased sales volume.

For the six months ended March 31, 2005, we used $33,723 for the purchase of equipment and building improvements in connection with our manufacturing operations. Net property and equipment increased to $180,952 at March 31, 2005 as compared to $147,967 at September 30, 2004.

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 second 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.

Subsequent to the end of the second 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 Upper Merion Township, Pennsylvania, with an initial annual rent of $74,858, increasing to $129,437, plus annual operating expenses. We intend to move both our Philadelphia, Pennsylvania manufacturing, engineering and assembly facility and our Oaks, Pennsylvania offices into this facility in the third and fourth quarters of fiscal 2005. In connection with this move, we will incur moving expenses as well as other one-time expenses in connection with refitting the new facility to our specifications.

In addition, subsequent to the end of the second quarter of fiscal 2005, our wholly-owned subsidiary, Diversified Electronics Company, Inc., entered into a contract of sale, subject to certain contingencies, for the sale of our Philadelphia, Pennsylvania manufacturing, engineering and assembly facility for a sales price of $200,000. The estimated income to be recognized by Valley Forge upon sale is approximately $120,000, before moving costs, closing costs and taxes.

At March 31, 2005, we had cash and cash equivalents of $2,647,334. 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 March 31, 2005. As of March 31, 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 are 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. Except for the settlement of the lawsuit, entitled Jeffrey Turner and Cathryn Turner v. Phoenix Children's Hospital, Inc. , et al., our financial statements do not reflect any material amounts related to possible unfavorable outcomes of claims and lawsuits to which we are currently a party because we currently believe that such claims and lawsuits are either adequately covered by insurance or otherwise indemnified, and are not expected, individually or in the aggregate, to result in a material adverse effect on our financial condition. However, it is possible that our results of operations, financial position and cash flows in a particular period could be materially affected by these contingencies if we change our assessment of the likely outcome of these matters.

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

The Medical Device Industry Is Highly Competitive, And We May Be Unable to Compete Effectively with Other Companies.

In general, the medical technology industry is characterized by intense competition. We compete with established medical technology and pharmaceutical companies. Competition also comes from 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.

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. Competitive pressures could adversely affect our profitability.

The largest competitor for our neurosurgical generator is the Valleylab division of Tyco International Ltd. In addition, our product lines could compete with smaller specialized companies or larger companies that do not otherwise focus on neurosurgery. Our dental business is small compared to its principal competitors, which sell laser devices. Our new multi-functional bipolar electrosurgical system will compete with monopolar devices manufactured by the Valleylab division of Tyco International Ltd. Our lesion generator for the treatment of pain will compete with other manufacturers of generators. Finally, in certain cases our products compete primarily against medical practices that treat a condition with medications.

Our Business Depends Significantly On Key Relationships With Third Parties, Which We May Be Unable To Establish And Maintain.

Our current business model depends on our entering into and maintaining distribution or alliance agreements with third parties concerning product marketing and sales. Our most important agreement is with the Codman & Shurtleff, Inc., an affiliate of Johnson & Johnson, for the sale of our neurosurgery products. Sales to Codman accounted for 69% of our sales for the second quarter of fiscal 2005, 86% of our sales in fiscal 2004, and 92% of our sales in fiscal 2003. Under the agreement, which we entered into with Codman, as amended, our exclusive distributorship relationship will expire on July 15, 2005, and our nonexclusive distribution relationship will expire on December 31, 2005, unless otherwise agreed by the parties. Termination or nonrenewal of this relationship would require us to develop other means to distribute our

neurosurgery products through other channels and could adversely affect our sales, operations and growth. We do not currently have the internal means to distribute our products.

Our ability to enter into agreements with third parties depends in part on convincing them that our technology can help them achieve their goals and execute their strategies. This may require substantial time, effort and expense on our part with no guarantee that a relationship will result. We may not be able to establish or maintain these relationships on commercially acceptable terms. Our future agreements, or our marketing and selling efforts to sell our products through other channels, may not ultimately be successful. Even if we enter into distribution or alliance agreements, the contracting parties could terminate these agreements, or these agreements could expire before meaningful milestones are reached. The termination or expiration of any of these relationships could have a material adverse effect on our business.

Much of the revenue that we may receive under third party distribution or alliance agreements will depend upon our distributors' ability to successfully introduce, market and sell our products. Our success depends in part upon the performance by these distributors of their responsibilities under these agreements or our ability to market or distribute our products through other channels. Some distributors may not perform their obligations when and as we expect. Thus, revenues to be derived from distributors may vary significantly over time and be difficult to forecast. Some of the companies we currently have distribution agreements with or are targeting as potential allies offer products competitive with our products or may develop competitive production technologies or competitive products without our participation, which could have a material adverse effect on our competitive position.

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.

Our Products May Not Be Accepted In The Market Or May Not Effectively Compete With Other Products Or Technologies.

We cannot be certain that our current products or any other products that we may develop or market will achieve or maintain market acceptance. 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 other treatments have a long history of use.

We cannot be certain that our devices and procedures 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.

In addition, our future success depends, in part, on our ability to develop additional products. Competitors may develop products that are more effective, cost less, or are ready for commercial introduction before our products. If we are unable to develop additional commercially viable products, our future prospects could be adversely affected.

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. In addition, limited funding available for product and technology acquisitions by end users of our products, as well as internal obstacles to end user approval of purchases of our products, could harm acceptance of our products. The industry is subject to rapid and continuous change arising from, among other things, consolidation and technological improvements. One or more of these factors may vary unpredictably, which could materially adversely affect our competitive position. We may not be able to adjust our plan of development to meet changing market demands.

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 and/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.

Our Competitive Position Depends, In Part, Upon Unpatented Trade Secrets Which We May Be Unable To Protect.

Our competitive position is furthermore dependent upon unpatented trade secrets. Trade secrets are difficult to protect. We cannot assure you that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets, that our trade secrets will not be disclosed, or that we can effectively protect our rights to unpatented trade secrets.

In an effort to protect our trade secrets, we generally require 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. We cannot assure you, however, that these agreements will 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 Become Subject to a Patent Litigation

The medical device industry has been characterized by extensive litigation regarding patents and other intellectual property rights, and companies in the medical device industry have employed intellectual property litigation to gain a competitive advantage. We cannot assure you that we will not become subject to patent infringement claims or litigation or interference proceedings declared by the United States Patent and Trademark Office to determine the priority of invention.

It May Be Difficult To Replace Some Of Our Suppliers.

Outside vendors, some of whom are sole-source suppliers, provide key components and raw materials used in the manufacture of our products. For example, we currently subcontract the manufacturing of our disposable cord and tubing sets with a single manufacturer. Although we believe that alternative sources for many of these components and raw materials are available, any supply interruption could harm our ability to manufacture our products until a new source of supply is identified and qualified. In addition, an uncorrected defect or supplier's variation in a component or raw material, either unknown to us or incompatible with our manufacturing process, could harm our ability to manufacture products. We may not be able to find a sufficient alternative

supplier in a reasonable time period, or on commercially reasonable terms, if at all, and our ability to produce and supply our products could be impaired. If we were suddenly unable to purchase products from one or more of our suppliers, we could need a significant period of time to qualify a replacement, and the production of any affected products could be disrupted. While it is our policy to maintain sufficient inventory of components so that our production will not be significantly disrupted even if a particular component or material is not available for a period of time, we remain at risk that we will not be able to qualify new components or materials quickly enough to prevent a disruption if one or more of our suppliers ceases production of important components or materials.

If Our Manufacturing Facility Was Damaged And/Or Our Manufacturing Processes Interrupted, We Could Experience Lost Revenues And Our Business Could Be Adversely Affected.

We manufacture our bipolar generators and irrigators at one facility. Damage to this facility due to fire, natural disaster, power loss, communications failure, unauthorized entry or other events could cause us to cease development and manufacturing of some or all of these products. Although we maintain property damage and business interruption insurance coverage on this facility, we may not be able to renew or obtain such insurance in the future on acceptable terms with adequate coverage or at reasonable costs.

Managing The Move Into Our New Manufacturing, Assembly, Engineering and Office Space May Affect Our Ability To Meet Product Delivery Requirements.

We have recently entered into a combined sublease and lease for approximately 13,500 square feet of assembly, engineering, manufacturing and office space in Upper Merion Township, Pennsylvania and anticipate moving our entire operations during the third and fourth quarters of fiscal 2005. Moving our operations may result in a significant disruption in our assembly, manufacturing, inventory, shipping, engineering and research and development abilities and further result in erosion of our anticipated revenues and earnings. Many matters could affect the move, including the time required to ready our new facility, the time required to plan and execute the move, our ability to quickly resume operations in the new facility and the additional burden on our management team to plan and complete this relocation.

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 two quarters of fiscal 2005 and during fiscal 2004 and 2003, our common stock has traded in a range of $1.05 and $2.40 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; and
- economic and political conditions.

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 March 31, 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 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

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

(b) Current Reports on Form 8-K

On January 26, 2005, Valley Forge Scientific Corp. filed a

report on Form 8-K regarding the resignation of certifying accountant and the engagement of a new certifying accountant.

On February 14, 2005, Valley Forge Scientific Corp. filed a report on Form 8-K regarding an earnings press release.

On February 16, 2005, Valley Forge Scientific Corp. filed a report on Form 8-K regarding the appointment of a principal officer.

On March 15, 2005, Valley Forge Scientific Corp. filed a report on Form 8-K regarding an amendment to an agreement with Codman & Shurtleff, Inc.

Subsequent to the end of the quarter, Valley Forge Scientific Corp. made the following filings:

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 filed a report on Form 8-K regarding an amendment to an agreement with Codman & Shurtleff, Inc.

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: May 13, 2005

By: /s/ JERRY L. MALIS

Jerry L. Malis, President and Chief Executive Officer (principal financial officer)

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EXHIBIT INDEX

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