PARAGON
TECHNOLOGIES

To The Shareholders of Paragon Technologies:

Paragon's per share book value decreased by approximately 35% in 2013 to $1.92 per share, compared with $2.97 per share in 2012. If you will recall in last year's annual report, it was stated that book value per share was $3.14 in 2012. The readjustment was a result of the Company's application of the equity method of accounting for our investment in SED International Holdings, Inc. in 2013. That application required going back in 2012 and applying the equity method as if it were in place in 2012, which resulted in an approximate $200,000 reduction in shareholder equity.

The decline in Paragon's book value was a direct result of the Company's investment in SED International. Paragon invested approximately $3 million into SED and that investment was written-down completely in the fourth quarter of 2013.

In the fourth quarter of 2013, accounting rules determined that Paragon's entire investment in SED International would have to be written-down to zero. Paragon owns approximately 27% of the outstanding stock of SED and two Paragon directors are SED directors. As such, Paragon is deemed to have an *ability to exercise significant influence* on SED International. U.S. GAAP rules require the equity method of accounting in valuing SED, which requires Paragon to include in its income statement the gains and losses from its investment in SED. Although SED continues to trade on the OTC market under the symbol "SEDN," SED has not released financial statements since its 2013 fiscal year ended June 30, 2013. Therefore, accounting rules require a complete write-down of the investment. While valid arguments might be made to the contrary, a conservative approach was determined to be prudent. I will provide more color on SED and Paragon's other investment activities in a later section of this letter.

As Paragon continues to evolve into a holding company with potentially diversified business operations, the Board took some measured steps with respect to the Company's future. In May 2014, I assumed the additional role of CEO of Paragon Technologies, replacing Larry Strayhorn. As Paragon comes to own or invest in more than one subsidiary, there needs to be a division of leadership at the parent level. Also in May, John Molloy joined the Company as President and CEO of SI Systems. Later this month, Deborah Mertz will join the Company as Chief Financial Officer of Paragon, replacing Jacob Cherian who is no longer with the Company. Both Paragon and SI are at crucial inflection points and it was prudent to make these key changes in moving the business forward. John Molloy brings over 30 years of financial and executive management experience and has been a key figure in the material handling industry for nearly fifteen years. Deborah has over thirty years' experience as an accounting and finance professional serving both public and private companies. We welcome them both to SI Systems and Paragon and look forward to their contributions.

2013 In Review

Paragon reported a net loss of $1.8 million in 2013 as a result of the write-down of the investment in SED. Operating income from our wholly owned subsidiary SI Systems was $901,000, compared with an operating loss of $360,000 in 2012. Revenues increased by over 30% to $11.6 million while operating expenses, as a percentage of revenue, equated to 23%, compared with 28% in 2012.

In 2013, SI's operating income was positively impacted by a customer order that was received and subsequently cancelled, but under the terms of the transaction led to an approximately $400,000 benefit to operating income. This type of favorable situation is not expected to occur in 2014.

In April 2013, SI Systems acquired Innovative Automation (IA), a San Diego based software company for $562,500, consisting of cash payments of $212,500 and a note payable in the amount of $350,000 payable over a period of time. As part of the purchase agreement, the seller may also receive earn-out payments during the five-year period after the closing date. IA's software adds a layer of order fulfillment capabilities to SI as the company works towards enhancing its Order Fulfillment Systems capabilities. The addition of IA Software has had a positive impact on SI Systems, however the integration between the two companies was lackluster in 2013 and we are optimistic that new leadership at SI will maximize IA's potential.

SI Systems, during the course of its 50-year plus history, has provided automated material handling solutions via two distinct branded channels: SI Production and Assembly Systems (PAS) and SI Order Fulfillment Systems (OFS). Historically, the SI Systems PAS channel has been the driving force of our material handling business. The PAS business has a principal focus on providing material handling solutions to manufacturing and assembly line operators in North America. Past PAS customers have included Caterpillar, Harley Davidson, Oshkosh and The United States Postal Service. If you imagine a typical assembly line plant with boxes or parts moving across a horizontal transportation line, our PAS business was responsible for building those types of systems.

To a large extent, the PAS business represents the "old" material handling industry when the United States was a manufacturing powerhouse during the twentieth century. While the PAS side of the material handling business has shrunk considerably over the past couple of decades, the economic rebound over the past several years has caused an uptick in manufacturing activity in the U.S. I'm not sure I would agree with those who predict that U.S. manufacturing is coming back in a big way but the rebound in manufacturing activity in the United States has been noticeable. Manufacturing contributed $2.1 trillion to U.S. GDP in 2012, up from $1.7 trillion five years earlier. Yet, as a percentage of overall GDP, manufacturing now represents 12.4% of GDP compared with 13.3% a decade ago, and nearly 16% fifteen years ago.

However, as the PAS market has declined, so have the providers, leaving SI Systems as one of very few players serving this much smaller yet still existing market. SI's PAS business currently has an installed base of approximately 200 customers that we feel could continue to provide SI a very stable source of recurring cash flows. The new management team plans to evaluate this existing installed base in order to truly understand the extent of the potential opportunity. With very little additional capital expenditure, the PAS business continues to provide a stable source of revenue and cash flow. Recognizing that the future of SI will be less dependent on PAS, we will nevertheless continue to exploit this portion of our business. In 2013, 67% of SI Systems revenue came from PAS contracts.

SI Systems OFS provides order fulfillment systems to distribution operations. The acquisition of IA Software gave SI the platform to expand its OFS services. Unlike the PAS segment in which solutions are sold directly to the end user, SI Systems OFS has the ability to go to market either directly to the end user or through a network of systems integrators.

The material handling industry today is best explained by visualizing a pyramid structure. At the top of the pyramid are the complete systems solutions suppliers (Schaefer Systems, Daifuku, and Dematic being the top three based on worldwide revenue in 2013). In the middle are dozens of the second tier material handling suppliers who are focused on serving and selling to the OEM integrators. The bottom base of the pyramid consists of all the other small, niche providers of material handling solutions, including SI Systems.

As SI moves forward we will continue to exploit our PAS business leveraging our current customers and existing installed base while using the SI brand to seek new customers or bigger portions of existing contracts. More so, we will focus on growing the OFS business – by far the largest growing sector in the material handling market – in order to solidify SI's future in the growing and emerging material handling markets. Rather than trying to compete against the top tier group, our view is that a partnership strategy with the second tier of the market may offer the most significant opportunity for SI.

As SI continues to build out its OFS capabilities, our expectation is that SI will be able to offer our potential customers complete packages consisting of both hardware and software solutions, creating a more versatile and consistent product.

We remain committed to our material handling operations. That commitment however comes with the responsibility of ensuring that any capital allocated provides an appropriate return that can be measured over a period of years. That process is ongoing at SI and John's skill and acumen should provide some very informative insight into how to best approach the future for SI.

<u>SED International Holdings, Inc.</u>

On October 17, 2013, Paragon Technologies and its slate of directors replaced the prior Board at SED. I was elected Chairman. Prior to joining the Board, Paragon had expressed its concern due to the financial degradation of SED as well our growing concern about the competency and integrity of the then-existing Board and management. On October 17, we realized we had underestimated the gross negligence that had indeed plagued SED.

In January 2014, I assumed the additional role of Interim CEO. With Paragon being SED's single largest shareholder, the SED Board and I came to the conclusion that the credibility of SED was best served by having leadership with the most skin in the game. SED, a 34 year old company, had managed in a few short months prior to our arrival to nearly destroy its reputation with its suppliers. When we came aboard in October, there was little to no dialogue between SED and its suppliers – the lifeblood of any distribution business.

As the CEO, I took the personal responsibility of managing every single supplier relationship, regardless of size and irrespective of whether or not that supplier was part of SED going forward. All the suppliers are important; for SED to have any chance of rebuilding itself, resolving its issues and rebuilding its relationships with suppliers is paramount.

What we found in October was a company with over 100 different suppliers, most of whom SED was not engaged with profitability. What we did was immediately segregate the core suppliers with the non-core suppliers and began the uphill climb in reestablishing the company's credibility. While SED's credibility with its core partners has improved dramatically, SED still faces the challenges of overcoming its legacy liabilities. SED has made significant progress to date on resolving many of these liabilities, however, work remains with respect to the company's liabilities in order to ensure the viability of SED going forward.

From an operational perspective, the simple part is that we believe we have identified the problem at SED – poor management and leadership over recent years, and little actual Board oversight. As to what SED will become when we are done with our turnaround is still uncertain. SED is working vigorously with its suppliers and other vendors and continues to make progress in working through its liabilities. In the short-term, the focus at SED – and my primary responsibility as CEO – is in continuing to reach resolutions with suppliers.

The intermediate term goal, already in progress, consists of SED re-focusing on its core competency: the distribution of IT products and components. SED's turn for the worse occurred in 2012 when the company acquired Lehrhoff. The Lehrhoff acquisition turned SED into a distributor of consumer electronics, small appliances, and personal care items – perhaps a viable business – that SED executives simply were unprepared and inexperienced to successfully integrate. The subsequent failure to execute proved disastrous. Distributing a vacuum cleaner or toothbrush may be similar in many respects, but there are differences that management clearly failed to see and understand.

The Lehrhoff acquisition was nearly catastrophic. While it is hard to ascertain an exact number, the $4.1 million purchase price that SED made to acquire this business resulted in SED burning an additional estimated $15 million in less than two years due to additional warehouse expansion expense, inventory write-downs, severances, integration expenses, legal costs and settlements.

As of today, SED has all but fully exited this business. What remains are the legacy inventory and a few contracts that will naturally wind down over the course of time as SED works towards final closure.

In the interim, SED has refocused itself as a niche distributor of IT products and components to the enterprise and commercial markets. From that vantage point, SED has the opportunity to truly become a top niche middle market distribution company with a focus on serving the small and medium business segments of the market. With this medium term focus, SED has rationalized its vendor line from over 100 to less than 30 suppliers who have been identified as being strategic to SED. These suppliers are the premier suppliers in IT, enabling SED to provide a deep bench of products and services in the most attractive market segments including memory, data storage, and system building and configuration.

The long-term goal for SED is to use its core competency to broaden the company's reach and specialization. As the company reestablishes its relationships with key suppliers, it will leverage those relationships to take SED into markets while offering suppliers increased customer breadth. An example of this strategy is the recent announcement between SED and Seagate moving into the surveillance market. To be sure, in years past SED was one of the key distributors of surveillance components before the company over-diversified.

Furthermore, SED will aim to strategically align itself with new top tier suppliers that not only extend SED's product line but complement what SED already does. This approach will allow SED to truly establish itself in rapidly-growing markets like mobility and big data as well as penetrate deeper into existing markets by offering a more comprehensive and specialized product line, expand its customer base, increase customer loyalty and profitability by offering customized IT products, and expanding the company's product line. In addition, SED will continue to refine its e-commerce capabilities as that becomes a very important way of generating incremental sales with little to no variable cost. The goal is for SED to become a niche distribution channel partner that connects the world's top suppliers to the small and medium business customer, the biggest and most lucrative segment for IT products and services today.

In order to consummate and pursue our intermediate and long-term goals, SED must resolve its immediate goal of curing its past liabilities, reestablishing and growing its relationships with suppliers and customers, and curing the company's delinquent filing status. All three are the top priorities at SED and they are being addressed with a concentrated measure of intensity and focus throughout the entire organization. Success here is essential.

Investment Activities

As stated in the previous annual letter, with respect to capital allocation at Paragon, our decisions continue to support retaining and allocating our capital believing that Paragon's overall intrinsic value *over the long run* is better served.

On the acquisition front, our strong preference is to buy entire businesses. Absent such opportunities, we will seek partial ownership interests in businesses that we deem attractively valued. Regardless of whether we are buying an entire business or a partial interest therein, the hurdle remains unchanged: over time we must believe we can earn more than a dollar's worth of value for every dollar invested.

Because this framework is critical to Paragon's approach, and even more critical for shareholders to understand in order to properly evaluate Paragon, we repeat the five pillars outlined in last year's letter:

1. Intelligent capital allocation is the most important driver of long-term intrinsic value creation; therefore, we will structure incentives and responsibilities in accordance with that philosophy.
2. What matters most in the long run is growth in per share value, not overall growth: we don't want to become the longest train, but the one that can travel the furthest on the least amount of fuel.
3. We favor a decentralized organizational structure which serves to maximize business output and minimize costs.
4. Independent, rational thinking is paramount to long-term success. The short-term focus behind Wall Street's modus operandi – reflected in the attention given to earning's guidance and quarterly results – is a distraction that we will strive to avoid.
5. Patience is a tremendous asset in business and the allocation of capital. We will act only inasmuch as fertile opportunities present themselves, and not because everyone else is buying or selling. We will not hesitate to bet big or act boldly when presented with opportunities to do so.

As CEO and chief capital allocator at Paragon shareholders are, to a great extent, relying on my ability to effectuate value creating decisions that result in an increase in Paragon's intrinsic value.

Through Gad Capital and my personal holdings, I beneficially own over 20% of the outstanding shares of Paragon. Attentive readers may notice that my ownership interest in Paragon has declined year over year. That was a result of natural redemptions by limited partners in Gad Capital who took equity redemptions. My personal holdings remain unchanged, and it is likely that they will increase significantly over time.

Simply put, I stand to benefit tremendously when Paragon's per share value is increased. More importantly, I will experience the greatest financial pain as a result of any deterioration in Paragon's value.

Marketable Securities

The following chart lists our investments with an aggregate market value of $100,000 or more as of May 31, 2014:

Security	Cost Basis	Market Value (as of 5/31/14)
Common Stock		
1,430,960 sh SED International	$3,103,996	$357,715**
Preferred Stock		
12,000 sh Meritage Hospitality 8% Series B	$128,037	$149,520

**As of March 31, 2014 Paragon's investment in SED was fully written off per equity method of accounting under U.S. GAAP.

Meritage Hospitality is a position initiated by Paragon in 2012. The preferred stock was purchased at an average cost of $9.15 per share against a par value of $10 per share. The 8% stated yield means our actual annual yield is 9%. Meritage has made uninterrupted dividend payments on the Series B for 40 consecutive quarters. Additionally, the preferred is convertible in the common stock of Meritage at a price of $5.57 per share. When we purchased the preferred two years ago, Meritage common was trading for $3. Today the shares trade for $5 as CEO Bob Schremer continues to expand his franchise business. We couldn't be happier.

Paragon has also made its first investment in a property and casualty insurance company. Currently Paragon is in the process of acquiring additional shares as they become available at attractive prices. The security is thinly traded, so at this time Paragon is better served by not disclosing the investment until we have completed acquiring our stake or securities regulations require disclosure. As of May 31, 2014, Paragon's investment in this insurance company has a cost basis of $127,500 and a market value of $143,000, respectively.

Currently, Paragon's investment portfolio consists of eight securities with an aggregate value of approximately $750,000 as of May 31, 2014.

The 2013 year was an inflection year for Paragon. Our wholly subsidiary, SI Systems, had a respectable year although a lot of exciting work remains in building SI's capabilities. While not a controlled entity, SED International represents the goal of creating a diversified holding company with one simple mandate: capital allocation that seeks to maximize **the long-term intrinsic value** of Paragon.

The Annual Meeting

The Annual Meeting/Shareholder Presentation will be held on Monday, July 14, at 9:00 a.m. -12:00 p.m. EST at the Cleveland offices of our corporate counsel, **Thompson Hine LLP, 3900 Key Center, 127 Public Square, Cleveland, Ohio 44114.** With shareholders and directors located across the United States, we thought we would give Cleveland a try this year to make travel arrangements more convenient.

Thompson Hine has again graciously agreed to host our annual meeting at no cost to Paragon (and our legal fees continue to be as low as ever; on many occasions the monthly tab is lower than what a receptionist would make). Our relationship with Thompson Hine, and our lead counsel Derek Bork, continues to benefit Paragon shareholders in countless ways. The meeting there last year ran smoothly thanks to all the wonderful folks at Thompson Hine.

Please follow the signs to the meeting. We will start the meeting promptly at 9:00 a.m., and we will devote the bulk of the meeting to shareholder Q&A. We encourage all shareholders to attend as this will provide the best forum to communicate with management.

On February 20, 2014 my mother Seham H. Gad lost a three year battle to breast cancer. She was 54. My mother never finished middle school and gave birth to me when she was nineteen years old. For the next 36 years, I was privileged to receive an education from her that continues to have immeasurable impact on my business career. She taught me the value of patience, commitment, and most of all, to value people and relationships. Business is simply the interaction among people in hopes of achieving a successful outcome. She was the best teacher I ever had and greatest mentor in my life.

Sincerely,

Hesham Gad,

Chairman and Chief Executive Officer

June 9, 2014