QUARTERLY REPORT

FOR THE PERIOD ENDED
September 30, 2012

PARAGON TECHNOLOGIES, INC.

600 Kuebler Road
Easton, PA 18040
Phone: 610-252-3205
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I.R.S. Employer Identification No.	CUSIP No.
22-1643428	69912T108

ISSUER'S EQUITY SECURITIES

COMMON STOCK

$1.00 Par Value
20,000,000 Common Shares Authorized
1,647,082 Shares Issued and Outstanding

PARAGON TECHNOLOGIES, INC.
Quarterly Report
For The Period Ended September 30, 2012

Item 1. Exact name of the issuer and the address of its principal executive offices:

The name of the issuer is Paragon Technologies, Inc. The issuer was formerly known as SI Handling Systems, Inc. until April 5, 2000.

Paragon Technologies, Inc.'s contact information is as follows:

Paragon Technologies, Inc.
Attention: Hesham M. Gad, Chairman
600 Kuebler Road
Easton, PA 18040-9201
Phone: .... (610) 252-3205
Fax: .... (610) 252-3102
Internet: .... www.sihs.com
E-mail: .... info@sihs.com

Item 2. Shares outstanding:

The number of shares or total amount of the securities outstanding for each class of securities authorized is as follows:

Quarter-End / Year-End Date	September 30, 2012	December 31, 2011	December 31, 2010
Number of shares authorized	20,000,000	20,000,000	20,000,000
Number of shares outstanding	1,647,082	1,554,310	1,554,310
Shares owned by directors and officers	433,803	515,615	435,415
Freely tradable shares (public float)	1,213,279	1,038,695	1,118,895
Total number of beneficial shareholders	372	354	410
Total number of shareholders of record	250	230	235

As of September 30, 2012, there were 1,647,082 shares of the Company's Common Stock issued and outstanding. As of the filing of this Quarterly Report, there were 1,656,854 shares of the Company's Common Stock issued and outstanding.

Item 3. Interim financial statements:

The Company's consolidated financial statements as of and for the period ended September 30, 2012 are incorporated by reference and can be found at the end of this Quarterly Report. The consolidated financial statements as of and for the period ended September 30, 2012 include (1) consolidated balance sheets, (2) consolidated statements of operations and comprehensive income, (3) consolidated statements of cash flows, (4) consolidated statements of stockholders' equity, and (5) notes to consolidated financial statements.

Item 4. Management's discussion and analysis or plan of operation:

The Company's Management Discussion and Analysis for the period ended September 30, 2012 is attached and is incorporated herein by reference.

Item 5. Legal proceedings:

None for the period ended September 30, 2012 and through the date of this report.

Item 6. Default upon senior securities:

None for the period ended September 30, 2012 and through the date of this report.

Item 7. Other information:

Not applicable.

Item 8. Exhibits:

None for the period ended September 30, 2012 and through the date of this report.

Item 9. Certifications:

I, Jacob Cherian, Chief Financial Officer of the issuer, certify that:

a. I have reviewed this Quarterly Report of Paragon Technologies, Inc.

b. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

c. Based on my knowledge, the consolidated financial statements, other financial information included or incorporated by reference in this disclosure statement, fairly present, in all material respects, the financial condition, results of operations, and cash flows of the issuer as of and for the periods presented in this disclosure statement.

November 14, 2012

/s/ Jacob Cherian
Jacob Cherian
Chief Financial Officer

I, Edward Larry Strayhorn, President and Chief Executive Officer of the issuer, certify that:

a. I have reviewed this Quarterly Report of Paragon Technologies, Inc.

b. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

c. Based on my knowledge, the consolidated financial statements, other financial information included or incorporated by reference in this disclosure statement, fairly present, in all material respects, the financial condition, results of operations, and cash flows of the issuer as of and for the periods presented in this disclosure statement.

November 14, 2012

/s/ Edward Larry Strayhorn
Edward Larry Strayhorn
President and Chief Executive Officer

Consolidated Financial Statements
Paragon Technologies, Inc. and Subsidiary
Consolidated Balance Sheets (Unaudited)
September 30, 2012 and December 31, 2011
(In Thousands, Except Share and Per Share Data)

	September 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 5,075	$ 4,871
Receivables:		
Trade accounts	871	838
Other receivables	11	15
Total receivables	882	853
Costs and estimated earnings in excess of billings	405	237
Inventories:		
Raw materials	160	160
Work-in-process	67	123
Finished goods	409	294
Total inventories	636	577
Prepaid expenses and other current assets	99	101
Total current assets	7,097	6,639
Marketable securities	218	-
Machinery and equipment, at cost:		
Machinery and equipment	1,177	1,208
Less: accumulated depreciation	1,087	1,096
Net machinery and equipment	90	112
Total assets	$ 7,405	$ 6,751

See accompanying notes to consolidated financial statements.

(Continued)

Consolidated Financial Statements *(Continued)*
Paragon Technologies, Inc. and Subsidiary
Consolidated Balance Sheets (Unaudited)
September 30, 2012 and December 31, 2011
(In Thousands, Except Share and Per Share Data)

	September 30, 2012	December 31, 2011
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 1,330	$ 698
Billings in excess of costs and estimated earnings	609	387
Accrued salaries, wages, and commissions	39	110
Accrued product warranties	108	76
Unearned support contract revenue	154	276
Accrued other liabilities	87	130
Total current liabilities	2,327	1,677
Commitments and contingencies *(See Notes 6 and 12)*		
Stockholders' equity:		
Common stock, $1 par value; authorized 20,000,000 shares; issued and outstanding 1,647,082 shares as of September 30, 2012 and 1,554,310 shares as of December 31, 2011	1,647	1,554
Additional paid-in capital	3,421	3,281
Retained earnings	4	239
Accumulated other comprehensive income	6	-
Total stockholders' equity	5,078	5,074
Total liabilities and stockholders' equity	$ 7,405	$ 6,751

See accompanying notes to consolidated financial statements.

<u>Consolidated Financial Statements</u> *(Continued)*
Paragon Technologies, Inc. and Subsidiary
Consolidated Statements of Operations and Comprehensive Income (Unaudited)
For the Nine Months Ended September 30, 2012 and 2011
(In Thousands, Except Share and Per Share Data)

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Net sales	$ 2,203	$ 1,991	$ 6,646	$ 6,714
Cost of sales	1,708	1,337	5,118	4,507
Gross profit on sales	495	654	1,528	2,207
Operating expenses:				
Selling, general and administrative expenses	526	567	1,712	1,901
Product development costs	5	10	61	31
Total operating expenses	531	577	1,773	1,932
Operating income (loss)	(36)	77	(245)	275
Other income (expense):				
Interest income	4	11	17	34
Interest expense	-	-	-	(1)
Other expense, net	2	(5)	(4)	(14)
Total other income (expense), net	6	6	13	19
Income (loss) before income taxes	(30)	83	(232)	294
Income tax expense (benefit)	1	(32)	3	(30)
Net income (loss)	(31)	115	(235)	324
Other comprehensive income:				
Unrealized gain on marketable securities	6	-	6	-
Income tax expense related to other comprehensive income	-	-	-	-
Other comprehensive income net of income taxes	6	-	6	-
Comprehensive income	$ (25)	$ 115	$ (229)	$ 324
Basic and diluted earnings (loss) per share	$ (0.02)	$ 0.07	$ (0.15)	$ 0.21
Weighted average basic and diluted shares outstanding	1,578,446	1,554,310	1,563,964	1,554,310

See accompanying notes to consolidated financial statements.

<u>Consolidated Financial Statements</u> *(Continued)*
Paragon Technologies, Inc. and Subsidiary
Statements of Cash Flows (Unaudited)
For the Nine Months Ended September 30, 2012 and 2011
(In Thousands)

	Nine Months Ended	
	September 30, 2012	September 30, 2011
Cash flows from operating activities:		
Net income (loss)	$ (235)	$ 324
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation of machinery and equipment	36	43
Loss on disposition of equipment	-	1
Issue of common stock in lieu of directors' fees	30	-
Change in operating assets and liabilities:		
Receivables	(29)	859
Costs and estimated earnings in excess of billings	(168)	(176)
Inventories	(59)	(52)
Prepaid expenses and other current assets	2	(19)
Accounts payable	632	(104)
Billings in excess of costs and estimated earnings	222	(596)
Accrued salaries, wages, and commissions	(71)	(46)
Accrued product warranties	32	42
Unearned support contract revenue	(122)	(185)
Accrued other liabilities	(43)	(33)
Net cash provided by operating activities	227	58
Cash flows from investing activities:		
Purchase of investments	(212)	-
Proceeds from the disposition of machinery and equipment	1	1
Purchases of machinery and equipment	(15)	(9)
Net cash used by investing activities	(226)	(8)
Cash flows from financing activities:		
Sale of common stock	203	-
Net cash used by financing activities	203	-
Increase in cash and cash equivalents	204	50
Cash and cash equivalents, beginning of year	4,871	4,892
Cash and cash equivalents, end of period	$ 5,075	$ 4,942
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest expense	$ -	$ 1
Income taxes	$ 25	$ 19

See accompanying notes to consolidated financial statements.

<u>Consolidated Financial Statements</u> *(Continued)*
Paragon Technologies, Inc. and Subsidiary
Consolidated Statements of Stockholders' Equity (Unaudited)
For the Nine Months Ended September 30, 2012 and 2011
(In Thousands, Except Share Data)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance at December 31, 2010	1,554,310	$ 1,554	$ 3,281	$ 48	$ -	$ 4,883
Net income	-	-	-	324	-	324
Balance at September 30, 2011	1,554,310	$ 1,554	$ 3,281	$ 372	$ -	$ 5,207
Balance at December 31, 2011	1,554,310	$ 1,554	$ 3,281	$ 239	$ -	$ 5,074
Net loss	-	-	-	(235)	-	(235)
Net change in unrealized gain on marketable securities	-	-	-	-	6	6
Issue of common stock in lieu of directors' fees under directors' stock plan	11,772	12	18	-	-	30
Sale of common stock for cash	81,000	81	122	-	-	203
Balance at September 30, 2012	1,647,082	$ 1,647	$ 3,421	$ 4	$ 6	$ 5,078

See accompanying notes to consolidated financial statements.

(1) <u>Basis of Financial Statement Presentation</u>

In the opinion of the management of Paragon Technologies, Inc. ("Paragon" or the "Company"), the unaudited interim consolidated financial statements furnished reflect all adjustments and accruals that are necessary to present a fair statement of results for the interim periods. Results for interim periods are not necessarily indicative of results expected for the full fiscal year.

This Quarterly Report should be read in conjunction with, and is qualified in its entirety by reference to, the Financial Statements of the Company and the related Notes thereto appearing in the Company's Annual Report for the year ended December 31, 2011 as filed with the OTC Markets Group Inc. on March 14, 2012. Refer to the Company's Annual Report for the year ended December 31, 2011 for more complete financial information.

Use of Estimates

The preparation of the consolidated financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The judgments made in assessing the appropriateness of the estimates and assumptions utilized by management in the preparation of the consolidated financial statements are based on historical and empirical data and other factors germane to the nature of the risk being analyzed. Materially different results may occur if different assumptions or conditions were to prevail. Estimates and assumptions are mainly utilized to establish the appropriateness of the inventory reserve, warranty reserve, and revenue recognition on fixed price contracts.

Principles of Consolidation

The consolidated financial statements include the accounts of Paragon Technologies, Inc. and SI Systems, Inc., a wholly-owned subsidiary, after elimination of intercompany balances and transactions.

(2) <u>Business Operations</u>

Company Overview

Paragon, based out of Easton, Pennsylvania, provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications through its wholly-owned subsidiary, SI Systems, Inc. ("SI Systems"). On May 24, 2012, the Company formed a wholly-owned subsidiary, "SI Systems", a Delaware corporation. On July 1, 2012, Paragon contributed substantially all of its assets, properties, rights, contracts, employees, including a portion of its cash, to SI Systems, and SI Systems assumed substantially all of the liabilities and obligations of Paragon relating to or arising out of Paragon's business activities in exchange for all of the authorized shares of SI Systems' common stock. SI Systems' capabilities include horizontal transportation, rapid dispensing, order fulfillment, computer software, sortation, integrating conveyors and conveyor systems, and aftermarket services. Paragon is a Delaware corporation, incorporated on November 21, 2001. Paragon was originally incorporated in Pennsylvania on June 18, 1958. Paragon changed its state of incorporation from Pennsylvania to Delaware on November 21, 2001.

(2) <u>Business Operations</u> *(Continued)*

Company Overview *(Continued)*

SI Systems is a specialized systems integrator supplying SI Systems' branded automated material handling systems to manufacturing, assembly, order fulfillment, and distribution operations customers located primarily in North America, including the U.S. government. SI Systems' branded products are utilized to automate the movement or selection of products and are often integrated with other automated equipment such as conveyors and robots. SI Systems is brought to market as two individual brands — SI Systems' Order Fulfillment Systems and SI Systems' Production & Assembly Systems.

(3) <u>Marketable Securities</u>

The Company's marketable securities portfolio is designated as available-for-sale by the Company's management. Securities classified as available-for-sale are those securities that the Company intends to hold for an indefinite period of time but not necessarily to maturity. Securities available-for-sale are carried at fair value. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Company's assets and liabilities, liquidity needs, capital considerations and other similar factors. Unrealized gains and losses are reported as increases or decreases in other comprehensive income. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings.

Declines in the fair value of securities below their cost that are deemed to be other than temporary impairments (OTTI) are reflected in earnings as realized losses. In estimating OTTI under the rules for accounting for certain debt and equity securities, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than amortized cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. In instances when a determination is made that an other-than-temporary impairment exists but the investor does not intend to sell the debt security and it is not more likely than not that it will be required to sell the debt security prior to anticipated recovery, the other-than-temporary impairment is separated into (a) the amount of the total other-than-temporary impairment related to a decrease in cash flows expected to be collected from the debt security (the credit loss) and (b) the amount of the total other-than-temporary impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income.

The Company has not recognized any other-than-temporary impairment losses for the three and nine month period ended September 30, 2012.

(3) Marketable Securities *(Continued)*

The amortized cost and approximate fair value of marketable securities available-for-sale as of September 30, 2012 and are summarized as follows (in thousands):

	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Equity Securities	$212	$12	$(6)	$218

At September 30, 2012, the Company had six equity securities in an unrealized loss position for less than 12 months. The decline in fair value is not due to credit losses. The Company does not intend to sell these securities prior to recovery and it is more likely than not that the Company will not be required to sell these securities prior to recovery and, therefore, no securities are deemed to be other-than-temporarily impaired.

There were no sales of securities for the three and nine month period ended September 30, 2012.

Fair value accounting guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 — Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 — Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 — Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

(3) Marketable Securities *(Continued)*

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2012 are as follows:

	2012			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity Securities	$218	$218	$ -	$ -

(4) Accrued Product Warranties

The Company's products are warranted against defects in materials and workmanship for varying periods of time depending on customer requirements and the type of system sold, with a typical warranty period of one year. The Company provides an accrual for estimated future warranty costs and potential product liability claims based upon a percentage of cost of sales, typically one and one-half percent of the cost of the system being sold. A detailed review of the liability needed for products still in the warranty period is performed each quarter.

A roll-forward of warranty activities is as follows *(in thousands)*:

	Beginning Balance January 1	Additions (Reductions) Included in Cost of Sales	Claims	Ending Balance September 30
2012	$ 76	37	(5)	108
2011	$ 71	26	(13)	84

(5) Line of Credit

On February 19, 2009, the Company established a $5,000,000 line of credit facility with its principal bank to be used primarily for working capital purposes. On December 1, 2010, the amount of the line of credit facility was reduced to $3,500,000. Interest on the line of credit facility is at the LIBOR Market Index Rate plus 1.25%. As of September 30, 2012 and December 31, 2011, the Company did not have any borrowings under the line of credit facility; however, the leasing agreement associated with the Company's principal office is secured with a $200,000 letter of credit at both September 30, 2012 and December 31, 2011 under the line of credit facility. Therefore, as of September 30, 2012 and December 31, 2011, the amount available under the line of credit was $3,300,000. There were no borrowings outstanding during the three and nine months ended September 30, 2012 and during the year ended December 31, 2011.

(5) Line of Credit *(Continued)*

The line of credit facility contains various non-financial covenants and is secured by all of the Company's accounts receivables and inventory. The Company was in compliance with all covenants as of September 30, 2012. The line of credit expires on November 30, 2012. On October 4, 2012, the Company's principal bank notified the Company that it will not be renewing the line of credit facility past November 30, 2012. The Company did not have outstanding borrowings on September 30, 2012 or November 14, 2012. The Company's outstanding Letter of Credit will expire in February 2013.

(6) Lease Commitment

The Company leases 22,700 square feet in Easton, Pennsylvania for use as its principal office. The leasing agreement requires fixed monthly rental payments of $18,000. The terms of the lease also require the payment of a proportionate share of the facility's operating expenses. The leasing agreement is secured with a $200,000 letter of credit. The lease expires on February 20, 2013.

(7) Stock Repurchase

There were no stock repurchases effected by the company during the three and nine months ended September 30, 2012.

(8) Revenue and Cost Recognition

Revenues on fixed price systems contracts are recorded on the basis of the Company's estimates of the percentage of completion of individual contracts. Revenue and gross profit is recognized on the basis of the ratio of aggregate costs incurred to date to the most recent estimate of total costs. As contracts may extend over one or more years, revisions in cost and profit estimates during the course of the work are reflected in the accounting periods in which the facts requiring revisions become known. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is accrued.

Contract costs include all direct material, subcontract and labor costs, and those indirect costs related to contract performance, including but not limited to costs such as indirect labor, supplies, tools, repairs, and depreciation. Selling, general and administrative costs are charged to expense as incurred. Changes in job performance, job conditions, and estimated profitability may result in revisions to costs and income, which are recognized in the period in which the revisions are determined.

The asset, "Costs and estimated earnings in excess of billings," represents revenues recognized in excess of amounts billed on uncompleted contracts. The liability, "Billings in excess of costs and estimated earnings," represents billings in excess of revenues recognized on uncompleted contracts.

(8) Revenue and Cost Recognition *(Continued)*

Revenues on other sales of parts or equipment are recognized when title transfers pursuant to shipping terms. There are no installation or customer acceptance aspects of these sales.

Revenue on individual support contracts is recognized on a straight-line basis over the one-year term of each individual support contract.

(9) Unearned Support Contract Revenue

The Company offers its Order Fulfillment customers one-year support contracts for an annual service fee. The support contracts cover a customer's single distribution center or warehouse where the Company's products are installed. As part of its support contracts, the Company provides analysis, consultation, and technical information to the customer's personnel on matters relating to the operation of its Order Fulfillment System and related equipment and/or peripherals.

The Company records advance payments for unearned support contracts in the balance sheet as a current liability that are in excess over amounts recognized as revenue at the end of each period. Revenue on individual support contracts is deferred and recognized on a straight-line basis over the one-year term of each individual support contract.

(10) Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with FASB authoritative guidance that addresses all forms of share-based payment awards, including shares issued under employee stock purchase plans, stock options, restricted and non-vested stock, and stock appreciation rights. It requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity-based compensation issued to employees.

The expense associated with stock-based compensation arrangements is a non-cash charge. In the Statements of Cash Flows, stock-based compensation expense would be an adjustment to reconcile net income (loss) to net cash provided (used) by operating activities.

2012 Equity Incentive Plan

On July 27, 2012, the Board of Directors of the Company adopted the Paragon Technologies, Inc. 2012 Equity Incentive Plan (the "Plan"). Under the Plan, the Board may grant restricted stock, stock options, stock appreciation rights and other equity-based awards to employees, directors and consultants of the Company. Initially, there are 200,000 shares of the Company's common stock available for grant under the Plan. The Plan provides that it will be administered by the Board or a committee of the Board that may be designated in the future. The Plan has a term of 10 years.

(10) Stock-Based Compensation *(Continued)*

Directors' Fees Paid in Equity

Commencing with the second half of 2012, Jack H. Jacobs and Samuel S. Weiser, directors of the Company, have agreed to be paid their retainer fees in shares of the Company's common stock. The shares of common stock will be issued to the directors under the Plan on a quarterly basis in advance and will be valued based on the average of the closing bid and asked prices for the Company's common stock on the OTC Markets for the 30 trading days immediately preceding July 1, 2012. The directors are paid their meeting fees in cash. The directors will continue to be paid their retainer fees in equity during 2013, unless this plan is amended by the Board. The Board plans to review the Company's Director Compensation Program for 2013 prior to the end of 2012. For the three and nine months ended September 30, 2012, the Company issued 11,772 shares to the directors under this plan, with an expense of $30,000.

Chairman's Compensation

In recognition of Mr. Hesham M. Gad's efforts and contributions to the Company in his role as Chairman, on September 14, 2012, the independent directors of the Board established Mr. Gad's annual compensation as Chairman as $110,000 per year effective June 1, 2012, to be paid $50,000 in cash and $60,000 in common stock of the Company under the Plan, with the common stock being valued based on the average of the closing bid and asked prices for the Company's common stock on the OTC Markets for the 30 trading days immediately preceding September 14, 2012. This compensation will be paid to Mr. Gad in lieu of all other board compensation and meeting fees. The compensation was determined by the Company's independent directors in consultation with the Company's outside counsel.

Employee Equity Grants

On August 28, 2012, in connection with the commencement of his employment as the Company's Chief Executive Officer and President, Mr. Strayhorn was granted an option to purchase 104,000 shares of the Company's common stock under the Plan. The option will vest, subject to Mr. Strayhorn's continued employment with the Company through the applicable vesting date, over a period of five years commencing on December 31, 2013.

On August 30, 2012, in connection with the commencement of his employment as the Company's Chief Financial Officer, Mr. Cherian was granted an option to purchase 45,000 shares of the Company's common stock. The option will vest, subject to Mr. Cherian's continued employment with the Company through the applicable vesting date, over a period of four years commencing on December 31, 2013.

Each of these options has an exercise price equal to the average of the closing bid and asked prices for the Company's common stock on the OTC Markets for the thirty trading days immediately preceding the grant date. The term of each of these options is ten years from the date of grant. In the event of a change in control of the Company, the vesting of each of these options will be accelerated.

The Company has also agreed to grant 3,000 restricted shares of the Company's common stock under the Plan to another recently hired employee of the Company, subject to his continued employment with the Company through February 1, 2013.

(11) Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Income tax expense is the tax payable or refundable for the period, plus or minus the change during the period in deferred tax assets and liabilities.

Tax benefits for uncertain tax positions are recognized when it is more likely than not that the position will be sustained upon examination based on its technical merits. The Company classifies interest and penalties related to unrecognized tax benefits as a component of income tax expense. To the extent interest and penalties are not assessed with respect to uncertain tax positions, amounts accrued will be reduced and reflected as a reduction of the overall income tax provision.

The Company has federal net operating losses of approximately $890,000 at December 31, 2011, expiring at various times through December 31, 2031. The Company has state net operating losses of approximately $2,700,000 at December 31, 2011, expiring of various times based on individual state limits.

Valuation allowances are provided to reduce the carrying amount of deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized. When assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in the appropriate taxing jurisdictions during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, taxable income in carryback years, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income, management has concluded that the Company's deferred tax assets are more likely than not to expire before the Company can use them, and, therefore, the Company's management has concluded that a full valuation allowance for deferred tax assets, net of deferred tax liabilities, was appropriate as of September 30, 2012 and December 31, 2011.

The valuation allowance of $717,000 as of September 30, 2012 was an offset of net deferred tax assets primarily related to inventory, warranty, net operating loss carryforwards, and other temporary differences.

The valuation allowance of $639,000 as of December 31, 2011 was an offset of net deferred tax assets primarily related to inventory, warranty, net operating loss carryforwards, and other temporary differences.

As of September 30, 2012 and December 31, 2011, there were no unrecognized tax benefits.

For the three and nine months ended September 30, 2012 and 2011, there was no expense related to interest and penalties, net of federal benefit, recognized in the statements of operations.

(11) Income Taxes *(Continued)*

The Company recognized income tax expense during the three months ended September 30, 2012 of $1,000 compared to an income tax benefit of $32,000 during the three months ended September 30, 2011. Income tax expense for the three months ended September 30, 2012 was primarily related to accruals for state income tax matters. There was no income tax benefit recognized for the loss for the three months ended September 30, 2012 as a result of the valuation allowance offsetting deferred tax assets. The income tax benefit for the three months ended September 30, 2011 primarily resulted from the carryback of 2010 federal and state net operating losses against income from previous years.

The Company recognized income tax expense during the nine months ended September 30, 2012 of $3,000 compared to an income tax benefit of $30,000 during the nine months ended September 30, 2011. Income tax expense for the nine months ended September 30, 2012 was primarily related to accruals for state income tax matters. There was no income tax benefit recognized for the loss for the nine months ended September 30, 2012 as a result of the valuation allowance offsetting deferred tax assets. The income tax benefit for the nine months ended September 30, 2011 primarily resulted from the carryback of 2010 federal and state net operating losses against income from previous years.

The Company is subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. The Company has substantially concluded all U.S. federal income tax matters for years through 2005. The Company files tax returns in approximately 30 state taxing jurisdictions. The Company has substantially concluded state income tax matters for years through 2003.

(12) Legal Proceedings

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. Although the amount of any liability that could arise with respect to currently pending actions cannot be accurately predicted, in the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations, or liquidity.

(13) Subsequent Events

Events and transactions for items that should potentially be recognized or disclosed in these financial statements occurring subsequent to the balance sheet date of September 30, 2012 have been evaluated through November 14, 2012, the date which these financial statements were available to be issued.

Line of Credit

On October 4, 2012, the Company’s principal bank notified the Company that it will not be renewing the line of credit facility past November 30, 2012. The Company does not have any outstanding borrowings on September 30, 2012 or November 14, 2012. The Company has a letter of credit outstanding that will expire in February 2013.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the unaudited consolidated financial statements and related notes thereto included in this Quarterly Report for the period ended September 30, 2012, and the cautionary statements and financial statements and related notes thereto included in the Company's Annual Report for the year ended December 31, 2011. The discussion and analysis contains "forward-looking statements" based on management's current expectations, assumptions, estimates, and projections. These forward-looking statements involve risks and uncertainties. The Company's actual results could differ materially from those included in these "forward-looking statements" as a result of risks and uncertainties identified in connection with those forward-looking statements, including those factors identified herein, and in the Company's other publicly filed reports.

Business Overview

Paragon Technologies, Inc. provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications through its wholly-owned subsidiary, SI Systems, Inc. Founded in 1958, the Company's material handling solutions are based on core technologies in horizontal transportation and order fulfillment and are aimed at improving productivity for manufacturing, assembly, and distribution center operations.

Results of Operations – Nine Months Ended September 30, 2012 Compared to the Nine Months Ended September 30, 2011

Earnings Summary

The Company had a net loss of $235,000 (or $0.15 basic loss per share) for the nine months ended September 30, 2012, compared to net income of $324,000 (or $0.21 basic earnings per share) for the nine months ended September 30, 2011. The decrease in net income was primarily due to a decrease during the first nine months of 2012 in gross profit of $679,000. Partially offsetting the decrease in net income was a decrease in selling, general and administrative expenses of $189,000 as described below.

Net Sales and Gross Profit on Sales

	2012	2011
Net sales	$ 6,646,000	6,714,000
Cost of sales	5,118,000	4,507,000
Gross profit on sales	$ 1,528,000	2,207,000
Gross profit as a percentage of sales	23.0%	32.9%

The decrease in sales was associated with a smaller backlog of orders entering 2012 when compared to the backlog of orders entering 2011.

Gross profit, as a percentage of sales, for the nine months ended September 30, 2012, when compared to the nine months ended September 30, 2011, was unfavorably impacted by 9.9% due to product mix variances.

Results of Operations – Nine Months Ended September 30, 2012 Compared to the Nine Months Ended September 30, 2011 *(Continued)*

Selling, General and Administrative Expenses

Selling, general and administrative expenses of $1,712,000 were lower by $189,000 for the nine months ended September 30, 2012 than for the nine months ended September 30, 2011. The favorable variance in selling, general and administrative expenses was primarily attributable to a decrease of $188,000 in professional fees.

Product Development Costs

Product development costs, including patent expense, of $61,000 were higher by $30,000 for the nine months ended September 30, 2012 than for the nine months ended September 30, 2011. Development programs in the nine months ended September 30, 2012 and 2011 were primarily aimed at improvements to the Company's Order Fulfillment systems technologies. Order Fulfillment development efforts during the nine months ended September 30, 2012 and 2011 included DISPENSIMATIC® hardware modifications and enhancements aimed at promoting workplace efficiencies for the Company's customers.

Interest Income

Interest income of $17,000 was lower by $17,000 for the nine months ended September 30, 2012 than for the nine months ended September 30, 2011. The decrease in interest income was attributable primarily to the reduced level of interest rates earned on funds available for investment.

Income Tax Expense

The Company recognized income tax expense during the nine months ended September 30, 2012 of $3,000 compared to an income tax benefit of $30,000 during the nine months ended September 30, 2011. Income tax expense for the nine months ended September 30, 2012 was primarily related to accruals for state income tax matters. There was no income tax benefit recognized for the loss for the nine months ended September 30, 2012 as a result of the valuation allowance offsetting deferred tax assets. The income tax benefit for the nine months ended September 30, 2011 primarily resulted from the carryback of 2010 federal and state net operating losses against income from previous years.

Results of Operations – Three Months Ended September 30, 2012 Compared to the Three Months Ended September 30, 2011

Earnings Summary

The Company had a net loss of $31,000 (or $0.02 basic loss per share) for the three months ended September 30, 2012, compared to net income of $115,000 (or $0.07 basic earnings per share) for the three months ended September 30, 2011. The decrease in net income was primarily due to a decrease during the third quarter of 2012 in gross profit of $159,000. Partially offsetting the decrease in net income was a decrease in selling, general and administrative expenses of $41,000 as described below.

Results of Operations – Three Months Ended September 30, 2012 Compared to the Three Months Ended September 30, 2011 *(Continued)*

Net Sales and Gross Profit on Sales

	2012	2011
Net sales	$ 2,203,000	1,991,000
Cost of sales	1,708,000	1,337,000
Gross profit on sales	$ 495,000	654,000
Gross profit as a percentage of sales	22.5%	32.8%

The increase in sales was associated with progress made on contracts received prior to the start of the year and during the first half of 2012 in accordance with job completion requirements.

Gross profit, as a percentage of sales, for the three months ended September 30, 2012, when compared to the three months ended September 30, 2011, was unfavorably impacted by 10.3% due to product mix variances.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of $526,000 were lower by $41,000 for the three months ended September 30, 2012 than for the three months ended September 30, 2011. The favorable variance in selling, general and administrative expenses was primarily attributable to a decrease of $49,000 in expenditures relating to sales efforts in response to quoting and sales activities.

Product Development Costs

Product development costs, including patent expense, of $5,000 were lower by $5,000 for the three months ended September 30, 2012 than for the three months ended September 30, 2011. Development programs in the three months ended September 30, 2012 and 2011 were primarily aimed at improvements to the Company’s Order Fulfillment systems technologies.

Interest Income

Interest income of $4,000 was lower by $7,000 for the three months ended September 30, 2012 than for the three months ended September 30, 2011. The decrease in interest income was attributable primarily to the reduced level of interest rates earned on funds available for investment.

Income Tax Expense

The Company recognized income tax expense during the three months ended September 30, 2012 of $1,000 compared to an income tax benefit of $32,000 during the three months ended September 30, 2011. Income tax expense for the three months ended September 30, 2012 was primarily related to accruals for state income tax matters. There was no income tax benefit recognized for the loss for the three months ended September 30, 2012 as a result of the valuation allowance offsetting deferred tax assets. The income tax benefit for the three months ended September 30, 2011 primarily resulted from the carryback of 2010 federal and state net operating losses against income from previous years.

Liquidity and Capital Resources

The Company's cash and cash equivalents at September 30, 2012 were $5,075,000, compared to $4,871,000, at December 31, 2011. The increase in cash and cash equivalents was primarily due to cash provided by operating activities totaling $227,000 and cash provided by financing of $203,000, partially offset by purchases of investments under the Investment Management Policy totaling $212,000 and other investing outlays of $14,000.

Cash provided by operating activities totaling $227,000 during the nine months ended September 30, 2012 was primarily due to the following factors:

- an increase in accounts payable in the amount of $632,000 associated with the purchase of goods and services rendered in accordance with job completion requirements; and
- an increase in customers' deposits and billings in excess of costs and estimated earnings in the amount of $222,000 in accordance with contractual requirements.

Partially offset by the following factors:

- a net loss in the amount of $235,000 for the first nine months of 2012;
- a decrease in unearned support contract revenue in the amount of $122,000 relating to the recognition of revenue on support contracts on the straight-line basis;
- a decrease in costs and estimated earnings in excess of billings in the amount of $168,000 in accordance with contractual requirements;
- a decrease in accrued salaries, wages, and commissions in the amount of $71,000 primarily associated with the payment of employee-related expenses; and
- an increase in inventories in the amount of $59,000 relating to the purchase of safety stock and long-lead time items.

The Company's cash and cash equivalents at September 30, 2011 were $4,942,000, compared to $4,892,000, at December 31, 2010. The increase was due to cash used by operating activities totaling $58,000.

Cash provided by operating activities totaling $58,000 during the nine months ended September 30, 2011 was primarily due to the following factors:

- a decrease in receivables in the amount of $859,000 in accordance with contractual requirements; and
- net income in the amount of $324,000 for the first nine months of 2011.

Partially offset by the following factors:

- an increase in costs and estimated earnings in excess of billings in the amount of $176,000 in accordance with contractual requirements;
- a decrease in customers' deposits and billings in excess of costs and estimated earnings in the amount of $596,000 in accordance with contractual requirements;
- a decrease in unearned support contract revenue in the amount of $185,000 relating to the recognition of revenue on support contracts on the straight-line basis;
- a decrease in accounts payable in the amount of $104,000 associated with payments for purchases of goods and services rendered in accordance with job completion requirements; and
- an increase in inventories in the amount of $52,000 relating to the purchase of safety stock and long-lead time items.

There were no stock repurchases during the nine months ended September 30, 2012 and September 30, 2011.

Liquidity and Capital Resources *(Continued)*

On February 19, 2009, the Company established a $5,000,000 line of credit facility with its principal bank to be used primarily for working capital purposes. On December 1, 2010, the amount of the line of credit facility was reduced to $3,500,000. Interest on the line of credit facility is at the LIBOR Market Index Rate plus 1.25%. As of September 30, 2012 and December 31, 2011, the Company did not have any borrowings under the line of credit facility; however, the leasing agreement associated with the Company's principal office is secured with a $200,000 letter of credit at both September 30, 2012 and December 31, 2011 under the line of credit facility. Therefore, as of September 30, 2012 and December 31, 2011, the amount available under the line of credit was $3,300,000. There were no borrowings outstanding during the three and nine months ended September 30, 2012 and during the year ended December 31, 2011. On October 4, 2012, the Company's principal bank notified the Company that it will not be renewing the line of credit facility past November 30, 2012. The Company did not have outstanding borrowings on September 30, 2012.

The line of credit facility contains various non-financial covenants and is secured by all of the Company's accounts receivables and inventory. The Company was in compliance with all covenants as of September 30, 2012.

The Company does not have any material commitments for capital expenditures as of September 30, 2012.

The Company anticipates that its financial resources, consisting of cash and cash equivalents, will be adequate to satisfy its future cash requirements through the next year. Sales volume, as well as cash liquidity, may experience fluctuations due to the unpredictability of future contract sales and the dependence upon a limited number of large contracts with a limited number of customers. Various external factors affect the customers' decision-making process on expanding or upgrading their current production or distribution sites. The customers' timing and placement of new orders is often affected by factors such as the current economy, current interest rates, and future expectations. The Company believes that its business is not subject to seasonality, although the rate of new orders can vary substantially from month to month. Since the Company recognizes sales on a percentage of completion basis for its systems contracts, fluctuations in the Company's sales and earnings occur with increases or decreases in major installations.

Contractual Obligations

The Company leases 22,700 square feet in Easton, Pennsylvania for use as its principal office. The leasing agreement requires fixed monthly rental payments of $18,000. The terms of the lease also require the payment of a proportionate share of the facility's operating expenses. The leasing agreement is secured with a $200,000 letter of credit. The lease expires on February 20, 2013.

Future contractual obligations and commercial commitments at September 30, 2012 as noted above are as follows:

	Contractual Obligations	Other Commercial Commitments
	Operating Leases	Letters of Credit
Payments due by period:		
2012	$ 54,000	$ -
2013	36,000	200,000
2014	-	-
2015	-	-
2016	-	-
After 2016	-	-
Total	$ 90,000	$ 200,000

Off-Balance Sheet Arrangements

As of September 30, 2012 and December 31, 2011, the leasing agreement associated with the Company's principal office is secured with a $200,000 letter of credit. As of September 30, 2012, the Company had no other off-balance sheet arrangements in the nature of guarantee contracts, retained or contingent interests in assets transferred to unconsolidated entities (or similar arrangements serving as credit, liquidity, or market risk support to unconsolidated entities for any such assets), obligations (including contingent obligations) under a contract that would be accounted for as a derivative instrument, or obligations (including contingent obligations) arising out of variable interests in unconsolidated entities providing financing, liquidity, market risk, or credit risk support to the Company, or that engage in leasing, hedging, or research and development services with the Company.

Cautionary Statement

Certain statements contained herein are not based on historical fact and are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and the Securities and Exchange Commission rules, regulations, and releases. The Company intends that such forward-looking statements be subject to the safe harbors created thereby. Among other things, the forward-looking statements regard the Company's earnings, liquidity, financial condition, and other matters. Words or phrases denoting the anticipated results of future events, such as "anticipate," "does not anticipate," "should help to," "believe," "estimate," "is positioned," "expects," "may," "will," "will likely," "is expected to," "will continue," "should," "project," and similar expressions that denote uncertainty, are intended to identify such forward-looking statements. The Company's actual results, performance, or achievements could differ materially from the results expressed in, or implied by, such "forward-looking statements": (1) as a result of risks and uncertainties identified in connection with those forward-looking statements, including those factors identified herein, and in the Company's other publicly filed reports; (2) as a result of factors over which the Company has no control, including the strength of domestic and foreign economies, sales growth, competition, and certain costs increases; or (3) if the factors on which the Company's conclusions are based do not conform to the Company's expectations.

Quantitative and Qualitative Disclosures About Market Risk

The Company does not believe that its exposures to interest rate risk or foreign currency exchange risk, risks from commodity prices, equity prices and other market changes that affect market risk sensitive instruments are material to its results of operations.
