



**QUARTERLY REPORT  
FOR THE PERIOD ENDED  
SEPTEMBER 30, 2018**

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**PARAGON TECHNOLOGIES, INC.**

101 Larry Holmes Drive, Suite 500  
Easton, PA 18042  
Telephone: 610-252-3205  
Fax: 610-252-3102

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**I.R.S. Employer Identification No.**

22-1643428

**CUSIP No.**

69912T108

**ISSUER'S EQUITY SECURITIES**

**COMMON STOCK**

**\$1.00 Par Value**

**20,000,000 Common Shares Authorized**

**1,694,745 Shares Issued and Outstanding  
as of the Filing of this Quarterly Report**

**PARAGON TECHNOLOGIES, INC.**

**Quarterly Report**

For the Three and Nine Months Ended September 30, 2018

**1) Name of the Issuer and its predecessors (if any):**

The name of the issuer is Paragon Technologies, Inc. ("Paragon" or the "Company").

**2) Address of the Issuer's principal executive offices:**

Company Headquarters

Paragon Technologies, Inc.

101 Larry Holmes Drive, Suite 500

Easton, PA 18042

Phone: (610) 252-3205

E-Mail: [info@pgntgroup.com](mailto:info@pgntgroup.com)

Website(s): [www.pgntgroup.com](http://www.pgntgroup.com)

IR Contact

Paragon Technologies, Inc.

101 Larry Holmes Drive, Suite 500

Easton, PA 18042

Phone: (706) 549-7141

E-Mail: [ir@pgntgroup.com](mailto:ir@pgntgroup.com)

Website(s): [www.pgntgroup.com](http://www.pgntgroup.com)

**3) Security Information:**

Trading Symbol: PGNT

Exact title and class of securities outstanding: Common Stock

CUSIP: 69912T108

Par Value: \$1.00 per share

Total shares authorized: 20,000,000

Total shares outstanding: 1,694,745

Transfer Agent

**Regular Mail**

Broadridge Shareholder Services

c/o Broadridge Corporate Issuer Solutions

P.O. Box 1342

Brentwood, NY 11717-0718

Or

**Overnight Mail**

Broadridge Shareholder Services

c/o Broadridge Corporate Issuer Solutions

1155 Long Island Avenue

Edgewood, NY 11717-8309

ATTN: IWS

Toll-free: (877) 830-4936

Toll: (720) 378-5591

Is the Transfer Agent registered under the Exchange Act: Yes:

No:

List any restrictions on the transfer of security:

None

Describe any trading suspension orders issued by the SEC in the past 12 months:

None

## **PARAGON TECHNOLOGIES, INC.**

### **Quarterly Report**

For the Three and Nine Months Ended September 30, 2018

#### **3) Security Information: (Continued)**

List any stock split, stock dividend, recapitalization, merger, acquisition, spin-off, or reorganization either currently anticipated or that occurred within the past 12 months.

On October 17, 2016, Ark Investments, LLC was formed as a wholly owned subsidiary of Paragon Technologies, Inc. and had no activity during the year ended December 31, 2016. On March 1, 2017, Ark Investments, LLC acquired SED International de Colombia, S.A.S. (SEDC), a Colombian based company, for a purchase price of \$1,395,000. SEDC distributes computer and technology systems in Colombia and Latin America. The Company purchased all the outstanding capital stock with cash. There is a minority interest in SEDC of (twenty) 20 percent owned by Ronell Rivera / El-Gibhor International LLC.

On December 11, 2017, Ohana Home Services, LLC was formed as a wholly owned subsidiary of Paragon Technologies, Inc. In December 2017, Paragon acquired residential real estate for \$750,000 and in January 2018, transferred title to Ohana for no consideration. In January 2018, Ohana acquired a second similar residential property for \$750,000.

#### **4) Issuance History:**

On January 23, 2018, a stock grant of 10,000 shares was made to an employee of the Company. The shares are unregistered and restricted under securities laws.

#### **5) Financial Statements:**

The financial statements for the three and nine months ended September 30, 2018 are incorporated by reference and can be found at the end of this Quarterly Report. The financial statements as of and for the three and nine month periods ended September 30, 2018 include: (1) consolidated balance sheets, (2) consolidated statements of operations, (3) consolidated statements of comprehensive income (loss), (4) consolidated statements of stockholders' equity, (5) consolidated statements of cash flows, and (6) notes to consolidated financial statements.

#### **6) Describe the Issuer's Business, Products, and Services:**

##### **A. Description of the issuer's business operations:**

###### **Business**

Paragon Technologies, Inc. ("Paragon" or the "Company"), is a holding company owning subsidiaries that engage in diverse business activities including material handling, distribution, real estate, and investments.

###### **Automation and Material Handling**

Our material handling operations are operated through our subsidiary, SI Systems, LLC. SI provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications. SI Systems' capabilities include horizontal conveyance and transportation, rapid dispensing and for order fulfillment, automatic document inserting system, a full suite of high performance Warehouse Execution Systems (WES), Warehouse Management Systems (WMS) and Warehouse Control Systems (WCS) software systems and aftermarket services. The newest addition to our material handling portfolio is the Effimat® line. Earlier this year, SI Systems was selected as a Master Distributor for North America by Effimat® Storage Technology of Denmark. SI Systems' automated material handling systems are used by manufacturing, assembly, order fulfillment, and distribution operations customers located primarily in North America, including the U.S. government.

## PARAGON TECHNOLOGIES, INC.

### Quarterly Report

For the Three and Nine Months Ended September 30, 2018

#### 6) Describe the Issuer's Business, Products, and Services: (Continued)

##### A. Description of the issuer's business operations: (Continued)

###### Automation and Material Handling (Continued)

SI Systems is brought to market as two individual brands, SI Systems' Dispensing and Towline. The Dispensing business focuses on providing order fulfillment systems to distribution operations, including Dispen-SI-matic®, Mobile-Matic® (a patented product), Doc-U-spense™ automatic document inserting system and our full suite of Warehouse Execution Systems, Warehouse Management Systems and Warehouse Control Systems software solutions with our SI-IWS™ product. These systems are sold primarily through a nationwide network of authorized material handling integrators, dealers and direct to major OEM, end users and 3PL accounts. All Effimat® products and services will be marketed with our other order fulfillment equipment. The Towline business focuses on providing automated material handling systems to manufacturing, assembly and distribution operations via our Lo-Tow® Towline horizontal conveyance and transportation technologies. These systems are sold primarily to end users.

SI Systems' business is largely dependent upon a limited number of large contracts with a limited number of customers. This dependence can cause unexpected fluctuations in sales volume. Various external factors affect the customers' decision-making process on expanding or upgrading their current production or distribution sites. Customers' timing and placement of new orders is often affected by factors such as the current economy, current interest rates, and future expectations. SI Systems 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 SI Systems' sales and earnings occur with increases or decreases in major installations.

SI Systems' branded products encompass the horizontal conveyance and transport and order fulfillment families of products.

SI Systems Lo-Tow® towline conveyor systems are utilized in the automation of manufacturing, assembly and unit load handling in the distribution center environments. Because the Lo-Tow® towline chain operates at a minimal depth, systems can be installed in existing one-story and multi-story buildings as well as newly constructed facilities. Industries served include the automotive, vehicle and large machinery manufacturing markets, distribution centers and U.S. government facilities.

SI Systems dispensing and order fulfillment systems are based on increasing customer profitability by reducing labor and floor space while increasing accuracy levels and the throughput and speed of order fulfillment to meet today's accelerated requirements. Product lines include:

- Dispen-SI-matic® Robotic A-Frame workstation system that provides benchmark setting levels for order fulfillment and the largest selection of model types in the industry.
- Mobile-Matic® (patented) mobile Robotic A-Frame system provides many of the key benefits of high speed order fulfillment, but in a smaller and scalable capacity.
- Doc-U-spense™ document insertion system which allows pre-printed coupons, instructions and documentation to be automatically added to orders accurately and labor-free. This system's modular construction allows organizations to cost-effectively add capacity and deploy rapidly.
- SI-IWS™ is a comprehensive suite of warehouse software designed to optimize material flow, labor and equipment utilization. The suite is comprised of a Warehouse Control System (WCS), Warehouse Management System (WMS) and Warehouse Execution System (WES) that allow organizations to match size, business model and requirements with the matching application requirements.

## **PARAGON TECHNOLOGIES, INC.**

### **Quarterly Report**

For the Three and Nine Months Ended September 30, 2018

#### **6) Describe the Issuer's Business, Products, and Services: (Continued)**

##### **A. Description of the issuer's business operations: (Continued)**

###### **Automation and Material Handling (Continued)**

- EffiMat® products include traditional Vertical Lift Modules known as ClassicMat™, as well as EffiMat® Microload systems. EffiMat® products complement existing dispensing products by providing solutions for items that are non-dispensable. SI Systems will offer sales, installation, service and support for all EffiMat® products.

Industries served include e-commerce and omni-channel retailers, pharmaceutical, entertainment, vision, nutritional supplements, electronics, health and beauty aids, cosmetics, jewelry and an assortment of other various industries.

SI Systems provides spare and replacement parts and equipment for all its products, along with support contract services for its order fulfillment systems. A service group focused on R&R (Rejuvenation & Retrofit) of existing topline systems (regardless of the manufacturer) has been very successful.

###### **Distribution**

Our distribution operations are carried out through our subsidiary SED International de Colombia ("SED Colombia" or "SEDC"). SED Colombia currently distributes IT hardware products, from 27 top worldwide leading IT manufacturers such as Hewlett Packard, Lenovo, Dell, Asus, Epson and others.

SEDC business is divided into three main business units: Value, Transactional and Integrated Services. The Value business unit focuses on enterprise sales and business projects, typically selling more specialized products that usually carry higher margins. The top products distributed by our Value unit include servers, workstations, storage, networking and power protection systems.

SEDC Transactional business unit focuses on the consumer business (retail resellers) as well as run rate products for Value Added Resellers (VAR'S) selling to small and medium businesses (SMB). The top products distributed by the Transactional business unit include notebook computers, desktop computers, printers, TVs, audio/visual equipment, projectors and accessories.

In July 2017, SEDC launched the Integrated Services business unit. The services provided by the new business unit include business cloud services, managed services, professional IT services, infrastructure IT solutions and internet of things (IOT) solutions. The Integrated Services unit has also taken ownership of the extended warranties and maintenance agreement sales.

###### **Real Estate**

In December 2017, Ohana Home Services, LLC, a wholly owned subsidiary of Paragon, was established to acquire real estate for income and capital appreciation purposes. In December 2017, Paragon acquired residential real estate in Las Vegas, Nevada for \$750,000. In January 2018, Paragon transferred title of the real estate to Ohana. There was no consideration exchanged between the parties. In January 2018, Ohana acquired a second similar residential property also in Las Vegas, Nevada for \$750,000. Ohana intends to lease its real estate to generate positive cash flow for the foreseeable future and may seek to monetize its real estate holdings during favorable market conditions.

**PARAGON TECHNOLOGIES, INC.**

**Quarterly Report**

For the Three and Nine Months Ended September 30, 2018

**6) Describe the Issuer's Business, Products, and Services: (Continued)**

**A. Description of the issuer's business operations: (Continued)**

**Investments**

Paragon also invests in businesses and securities under the Investment Management Policy. The Investment Management Policy sets forth the parameters under which a portion of Paragon's cash balance may be invested in marketable securities, including U.S. Treasuries, equities of publicly traded companies, bonds, money market instruments and other securities. Investment decisions under the Investment Management Policy are made by Hesham Gad, Chairman and Chief Executive Officer. The Investment Management Policy sets forth restrictions on the investment of Paragon's funds, including an aggregate limit on Paragon's cash balance that is made available for investment, limits on the amount that may be invested in any single equity or fixed income position or certain categories of securities, prohibition of short-selling, margin trading and the use of leverage, requirements for the management of the investment account, and other Board-approval requirements.

**B. Date and State (or Jurisdiction) of Incorporation:**

The Company was originally incorporated in Pennsylvania on June 18, 1958 as SI Handling Systems, Inc.

On April 5, 2000, SI Handling Systems, Inc. changed its name to Paragon Technologies, Inc.

The Company changed its state of incorporation from Pennsylvania to Delaware on November 21, 2001.

**C. The issuer's primary and secondary SIC Codes:**

Primary SIC Code:	3530 AND 5045
Secondary SIC Code:	N/A

**D. The issuer's fiscal year end date:**

The Company's fiscal year end is December 31.

**E. Principal products or services, and their markets:**

See section 6A.

**PARAGON TECHNOLOGIES, INC.**

**Quarterly Report**

For the Three and Nine Months Ended September 30, 2018

**7) Describe the Issuer’s Facilities:**

Paragon Technologies, Inc.  
101 Larry Holmes Drive, Suite 500  
Easton, PA 18042

SI Systems leases a facility located at 101 Larry Holmes Drive in Easton, Pennsylvania. The area covered by the lease is 9,648 square feet. The leasing agreement requires fixed monthly payments of \$13,500 through April 30, 2020, when the lease expires.

SI Systems believes that its Easton, Pennsylvania facility is adequate for its current operations. SI Systems operations experience fluctuations in workload due to the timing and receipt of new orders and customer job completion requirements. Currently, SI Systems facility is adequate to handle these fluctuations. In the event of an unusual demand in workload, SI Systems supplements its internal operations with outside subcontractors that perform services for SI Systems in order to complete contractual requirements for its customers. SI Systems will continue to utilize internal personnel and its own facility and, when necessary and/or cost effective, outside subcontractors to complete contracts in a timely fashion in order to address the needs of its customers.

SED Colombia leases a 32,000 square foot facility in Chia (Cundinamarca), Colombia. The center, located near Bogotá, the capital city of Colombia, serves as a sales and administrative office and distribution facility for SEDC. The lease expired in October 2018. The contract has not been extended; however, we anticipate entering into a month-to-month agreement. The monthly payment is the equivalent of approximately \$10,629.

SEDC also leases office space in Palmetto Bay, Florida, for a monthly payment of \$1,362 (the lease expires at the end of March 2019) and two apartments in Chia for use by its two members of the management team based out of Miami, Florida, for an aggregate monthly payment of the equivalent of approximately \$970. These leases expire in mid July 2019 and end of March 2019, respectively.

**8) Officers, Directors, and Control Persons:**

**A. Names of Officers, Directors, and Control Persons.**

Information concerning The Company’s directors is as follows:

Name, Other Positions or Offices With the Company and Principal Occupation for Past Five Years	Director Since	Age
Hesham “Sham” M. Gad .....	2010	40

**Hesham M. Gad** has been Chief Executive Officer of the Company since June 2014, Chairman of the Company’s Board of Directors since March 2012 and a director of the Company since October 2010. From 2013 to 2017 Mr. Gad served as Chairman and CEO of SED International Holdings, a multinational distributor of IT and computing products.

Mr. Gad is also the author of the internationally published book, “The Business of Value Investing.” Mr. Gad holds a B.A. in finance and an MBA in finance from the University of Georgia.

**8) Officers, Directors, and Control Persons: (Continued)**

**A. Names of Officers, Directors, and Control Persons. (Continued)**

Jack H. Jacobs	2012	73
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**Jack H. Jacobs**, age 73, is the Melcher Family Chair and Professor of Humanities and Public Affairs at the United States Military Academy at West Point, where he has been teaching since 2005, and a principal of The Fitzroy Group, Ltd., a firm that specializes in the development of residential real estate in London and invests both for its own account and in joint ventures with other institutions, for over 20 years. He has served as an on-air military analyst for NBC News since 2002. Colonel Jacobs was a co-founder and Chief Operating Officer of AutoFinance Group Inc., one of the firms to pioneer the securitization of debt instruments, from 1988 to 1989; the firm was subsequently sold to KeyBank. He was a Managing Director of Bankers Trust Corporation, a diversified financial institution and investment bank, where he ran foreign exchange options worldwide and was a partner in the institutional hedge fund business.

Colonel Jacobs' military career included two tours of duty in Vietnam where he was among the most highly decorated soldiers, earning three Bronze Stars, two Silver Stars and the Medal of Honor, the nation's highest combat decoration. He retired from active military duty as a Colonel in 1987. Colonel Jacobs has been a member of the board of directors of Datatrak International, Inc. (OTCMKTS: DTRK) since 2016, Resonant Inc. (Nasdaq: RESN) since 2018, and Ballantyne Strong, Inc. (NYSE American: BTN) since 2018. From 2007 to 2012, Colonel Jacobs served as a member of the Board of Directors of Xedar Corporation, a public company; from June 2006 to 2009, he was a director of Visual Management Systems, a private company; and he was a director of BioNeutral Group, Inc., a public company, until 2009. From October 17, 2013 to October 28, 2013, Colonel Jacobs served on the board of SED International Holdings, Inc. He was previously a director of Premier Exhibitions, Inc. Colonel Jacobs is Co-Chairman of the Medal of Honor Foundation and a member of the Board of Trustees of the USO of New York. He is the author of the book "If Not Now, When?: Duty and Sacrifice in America's Time of Need." Colonel Jacobs received a Bachelor of Arts and a Master's degree from Rutgers University.

Samuel S. Weiser.....	2012	58
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**Samuel S. Weiser** is currently the President and Chief Executive Officer of Foxdale Management LLC, a consulting firm founded by Mr. Weiser that provides operational consulting, strategic planning, and litigation support services in securities related disputes, which has been operating since 2003. From August 2009 until April 2015, he was a member of the Board of Directors and from August 2014 until March 2015 was Executive Chairman of Premier Exhibitions, Inc., a provider of museum quality touring exhibitions then listed on Nasdaq. In addition, Mr. Weiser served as President and Chief Executive Officer of Premier Exhibitions from November 2011 until June 2014. Mr. Weiser was a member of SED International's Board of Directors from October of 2013 until October 2014. Previously, Mr. Weiser served as a member and Chief Operating Officer of Sellers Capital LLC, an investment management firm, from 2007 to 2010. From 2005 to 2007, he was a Managing Director responsible for the Hedge Fund Consulting Group within Citigroup Inc.'s Global Prime Brokerage Division. Mr. Weiser also served as Chairman of the Managed Funds Association, a lobbying organization for the hedge fund industry, from 2001 to 2003 and was formerly a partner in Ernst and Young. He received his



**PARAGON TECHNOLOGIES, INC.**

**Quarterly Report**

For the Three and Nine Months Ended September 30, 2018

**8) Officers, Directors, and Control Persons: (Continued)**

**A. Names of Officers, Directors, and Control Persons. (Continued)**

B.A. in Economics from Colby College and a M.A. in Accounting from George Washington University.

The directors of the Company hold their positions as directors until the next Annual Meeting of Stockholders.

The names, ages, and offices with the Company of its executive officers are as follows:

<u>Name</u>	<u>Age</u>	<u>Office</u>
Hesham "Sham" M. Gad	40	Chief Executive Officer, Paragon Technologies
Deborah R. Mertz	62	Chief Financial Officer, Paragon Technologies

**Deborah R. Mertz** is an accounting professional with over 40 years' experience in both publicly held and privately held companies. From 2006 to 2013, Ms. Mertz held the position of Assistant Controller of ASSA ABLOY Inc. Americas Division. ASSA ABLOY is the largest global supplier of intelligent lock and security solutions. From 1999 to 2006, Ms. Mertz was the Controller/CFO of Sargent Manufacturing Company. Sargent Manufacturing Company is a wholly owned subsidiary of ASSA ABLOY Inc. and manufactures architectural hardware used primarily in commercial construction. Ms. Mertz has held various other senior accounting positions. Ms. Mertz is a CPA and has an MBA from Rider University and a B.S. in Accounting from King's College.

To the Company's knowledge, beneficial owners of more than 5% of the Company's common stock that are not listed above or in section C. Beneficial Shareholders, are as follows:

William Anthony Guegel  
Kevin W. Ting

**B. Legal/Disciplinary History. Please identify whether any of the foregoing persons have, in the last five years, been the subject of:**

1. A conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses).

The executive officers and directors of the Company have not, in the last five years, been the subject of a conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses).

2. The entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended, or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities.

The executive officers and directors of the Company have not, in the last five years, been the subject of the entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities.

**PARAGON TECHNOLOGIES, INC.**

**Quarterly Report**

For the Three and Nine Months Ended September 30, 2018

**8) Officers, Directors, and Control Persons:** *(Continued)*

**B. Legal/Disciplinary History. Please identify whether any of the foregoing persons have, in the last five years, been the subject of:** *(Continued)*

3. A finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated.

The executive officers and directors of the Company have not, in the last five years, been the subject of a finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated.

4. The entry of an order by a self-regulatory organization that permanently or temporarily barred, suspended or otherwise limited such person's involvement in any type of business or securities activities.

The executive officers and directors of the Company have not, in the last five years, been the subject of the entry of an order by a self-regulatory organization that permanently or temporarily barred, suspended or otherwise limited such person's involvement in any type of business or securities activities.

The Company has no information regarding beneficial owners of more than 5% of its common stock other than Mr. Gad, the Chief Executive Officer and the Chairman of the Company's Board of Directors.

**C. Beneficial Shareholders. Provide a list of the name, address and shareholdings or the percentage of shares owned by all persons beneficially owning more than ten percent (10%) of any class of the issuer's equity securities. If any of the beneficial shareholders are corporate shareholders, provide the name and address of the person(s) owning or controlling such corporate shareholders and the resident agents of the corporate shareholders.**

To the best of the Company's knowledge, the following table sets forth certain information as of September 30, 2018 (unless otherwise noted) regarding the ownership of common stock by each person known by the Company to be the beneficial owner of more than ten percent (10%) of the outstanding common stock. Unless otherwise stated, to the Company's knowledge, the beneficial owners exercise sole voting and/or investment power over their shares.

Title of Class	Name and Address of Beneficial Owner (1)	Amount and Nature of Beneficial Ownership	Right to Acquire Under Options Exercisable Within 60 Days	Percent of Class (2)
Common Stock, Par Value \$1.00 Per Share	Hesham M. Gad (3)	505,699	-	29.8%
	Donna Van Allen & Van Allen Investments, Inc.	245,000	-	14.4%

**PARAGON TECHNOLOGIES, INC.**

**Quarterly Report**

For the Three and Nine Months Ended September 30, 2018

**8) Officers, Directors, and Control Persons:** *(Continued)*

**C. Beneficial Shareholders** *(Continued)*

- (1) Hesham M. Gad's address is c/o Paragon Technologies, Inc., 101 Larry Holmes Drive, Suite 500, Easton, Pennsylvania 18042. The address for the Van Allens' is 410 Almeria Court, Winter Springs, Florida 32708. Based on public disclosures, Keith Van Allen is President of Van Allen Investments, Inc.
- (2) The percentage for each individual, entity or group is based on the aggregate number of shares outstanding as of 9/30/2018.
- (3) Mr. Gad holds 301,168 shares directly and beneficially owns 204,531 shares held by Gad Capital. The Van Allens hold 135,000 shares directly and beneficially owns 110,000 shares held by Van Allen Investments, Inc.

**9) Third Party Providers:**

Please provide the name, address, telephone number, and e-mail address of each of the following outside providers that advise your company on matters relating to operations, business development, and disclosure:

Legal Counsel:

Thompson Hine LLP  
Attention: Derek D. Bork  
3900 Key Center  
127 Public Square  
Cleveland, Ohio 44114-1291  
Telephone number: (216) 566-5500  
E-mail address: [Derek.Bork@thompsonhine.com](mailto:Derek.Bork@thompsonhine.com)

Auditor:

RSM US LLP  
Attention: Susan Roeder  
518 Township Line Rd, Suite 300  
Blue Bell, PA 19422  
Telephone number: (215) 641-8600  
E-mail address: [Susan.Roeder@rsmus.com](mailto:Susan.Roeder@rsmus.com)

Statutory Auditor: Colombia

RSM Colombia  
Attention: Jose Luis Salgado C.  
Avenida Calle 26 N 69D – 91 Of.  
303 / 306 / 702A Torre Peatonal.  
Centro Empresarial Arrecife.  
Bogota, Colombia  
Telephone number: +57 (1) 410 4122  
E-mail address: [jose.salgado@rsmco.co](mailto:jose.salgado@rsmco.co)

Investor Relations Consultant:

None.

Other Advisor:

None.

**PARAGON TECHNOLOGIES, INC.**  
**Quarterly Report**  
For the Three and Nine Months Ended September 30, 2018

**10) Issuer Certification:**

The issuer shall include certifications by the chief executive officer and chief financial officer of the issuer (or any other persons with different titles, but having the same responsibilities).

I, Hesham M. Gad, Chief Executive Officer, certify that:

1. I have reviewed this quarterly disclosure statement of Paragon Technologies, Inc.;
2. 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
3. Based on my knowledge, the financial statements, and 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 7, 2018

/s/ Hesham M. Gad  
Hesham M. Gad  
Chief Executive Officer

The issuer shall include certifications by the chief executive officer and chief financial officer of the issuer (or any other persons with different titles, but having the same responsibilities).

I, Deborah R. Mertz, Chief Financial Officer, certify that:

1. I have reviewed this quarterly disclosure statement of Paragon Technologies, Inc.;
2. 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
3. Based on my knowledge, the financial statements, and 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 7, 2018

/s/ Deborah R. Mertz  
Deborah R. Mertz  
Chief Financial Officer

**PARAGON TECHNOLOGIES, INC.  
and Subsidiaries**

# **QUARTERLY REPORT**

**CONSOLIDATED FINANCIAL STATEMENTS – UNAUDITED FOR THE  
NINE MONTHS ENDED SEPTEMBER 30, 2018**

## **CONSOLIDATED FINANCIAL STATEMENTS**

### **I N D E X**

**• Consolidated Financial Statements:**

Consolidated Balance Sheets, September 30, 2018 and December 31, 2017.....	2
Consolidated Statements of Operations for the three and nine months ended September 30, 2018, and 2017.....	4
Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2018, and 2017 .....	5
Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2018 and the years ended December 31, 2017, and 2016.....	6
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**PARAGON TECHNOLOGIES, INC.**  
Consolidated Balance Sheets (Unaudited)  
September 30, 2018 and December 31, 2017  
(In Thousands, Except Share and Per Share Data)

	September 30, 2018	December 31, 2017
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 952	\$ 2,040
Trade accounts receivables, net	11,263	12,643
Contract assets	-	90
Inventories:		
Raw materials	137	128
Work-in-process	1	1
Finished goods	11,227	10,916
Total inventories	11,365	11,045
Prepaid expenses and other current assets	4,732	3,881
Total current assets	28,312	29,699
Marketable securities	280	420
Real estate, machinery, equipment, software, land and leasehold impr. at cost:		
Real estate	1,500	750
Machinery and equipment	454	513
Software	475	643
Land	19	-
Leasehold Improvements	20	-
Less: accumulated depreciation	771	872
Net real estate, machinery, equipment, software, land and leasehold impr.	1,697	1,034
Other assets - intangible assets, net	566	616
Deferred tax asset	125	125
Total assets	\$ 30,980	\$ 31,894

*See accompanying notes to consolidated financial statements.*

*(Continued)*

**PARAGON TECHNOLOGIES, INC.**Consolidated Balance Sheets (Unaudited) *(Continued)*

September 30, 2018 and December 31, 2017

*(In Thousands, Except Share and Per Share Data)*

	September 30, 2018	December 31, 2017
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 15,588	\$ 14,103
Contract liabilities	1,455	1,119
Accrued salaries, wages, and commissions	322	209
Accrued product warranties	92	89
Income taxes payable	326	769
Accrued other liabilities	1,306	1,745
Bank loan - line of credit	5,687	7,836
Total current liabilities	<u>24,776</u>	<u>25,870</u>
Commitments and contingencies (Notes 9 and 10)		
Stockholders' equity:		
Common stock, \$1 par value; authorized 20,000,000 shares; issued and outstanding 1,694,745 shares as of September 30, 2018 and 1,684,745 as of December 31, 2017	1,695	1,685
Additional paid-in capital	3,500	3,499
Retained earnings	172	104
Accumulated other comprehensive (loss)	(207)	(304)
Total Paragon Technologies, Inc. and subsidiaries stockholders' equity	<u>5,160</u>	<u>4,984</u>
Noncontrolling interest in subsidiary	1,044	1,040
Total stockholders' equity	<u>6,204</u>	<u>6,024</u>
Total liabilities and stockholders' equity	<u>\$ 30,980</u>	<u>\$ 31,894</u>

*See accompanying notes to consolidated financial statements.*



**PARAGON TECHNOLOGIES, INC.**

## Consolidated Statements of Operations (Unaudited)

For the Three Months and Nine Months Ended September 30, 2018 and 2017

*(In Thousands, Except Share and Per Share Data)*

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Net sales	\$ 20,996	\$ 18,824	\$ 60,125	\$ 42,993
Cost of sales	18,825	16,664	54,581	38,372
Gross profit on sales	<u>2,171</u>	<u>2,160</u>	<u>5,544</u>	<u>4,621</u>
Operating expenses:				
Selling, general and administrative expenses	1,598	1,947	4,924	4,728
Product development costs	0	18	6	22
Total operating expenses	<u>1,598</u>	<u>1,965</u>	<u>4,930</u>	<u>4,750</u>
Operating income (loss)	<u>573</u>	<u>195</u>	<u>614</u>	<u>(129)</u>
Other income (expense)				
Interest income	5	41	21	102
Interest expense	(116)	(122)	(292)	(258)
Realized gain (loss) on investment, marketable securities	(6)	(48)	145	198
Unrealized loss on investment, equity securities	(5)	-	(6)	-
Gain on bargain purchase	-	-	-	4,226
Gain on sale of fixed assets	0	-	1	-
Total other income (expense), net	<u>(122)</u>	<u>(129)</u>	<u>(131)</u>	<u>4,268</u>
Income before income taxes and noncontrolling interest	451	66	483	4,139
Income tax expense	194	83	275	97
Net income (loss) before noncontrolling interest	257	(17)	208	4,042
Net income attributable to noncontrolling interest	25	834	54	830
Net income (loss) attributable to Paragon Technologies, Inc. and subsidiaries	<u>\$ 232</u>	<u>\$ (851)</u>	<u>\$ 154</u>	<u>\$ 3,212</u>
Basic and diluted income (loss) per share	<u>\$ 0.14</u>	<u>\$ (0.51)</u>	<u>\$ 0.09</u>	<u>\$ 1.91</u>
Weighted average shares outstanding	1,694,033	1,684,745	1,694,033	1,684,745
Dilutive effect of stock options	-	-	-	-
Weighted average shares outstanding assuming dilution	<u>1,694,033</u>	<u>1,684,745</u>	<u>1,694,033</u>	<u>1,684,745</u>

*See accompanying notes to consolidated financial statements.*

**PARAGON TECHNOLOGIES, INC.**

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)  
For the Three Months and Nine Months Ended September 30, 2018 and 2017  
(In Thousands, Except Share and Per Share Data)

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Net income (loss)	\$ 257	\$ (17)	\$ 208	\$ 4,042
Other comprehensive income (loss):				
Unrealized income (loss) on debt securities net of tax	(13)	(234)	79	(277)
Foreign currency translation	<u>(70)</u>	<u>207</u>	<u>18</u>	<u>30</u>
Comprehensive income (loss)	<u>\$ 174</u>	<u>\$ (44)</u>	<u>\$ 305</u>	<u>\$ 3,795</u>

*See accompanying notes to consolidated financial statements.*

**PARAGON TECHNOLOGIES, INC.**

Consolidated Statements of Stockholders' Equity (Unaudited)

For the Nine Months Ended September 30, 2018 and the Years Ended December 31, 2017 and 2016

(In Thousands, Except Share and Per Share Data)

	Common Stock		Additional Paid-Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Stockholders' Equity
	Shares	Amount					
Balance at January 1, 2016	1,684,745	\$ 1,685	\$ 3,499	\$ (1,552)	\$ (31)	\$ -	\$ 3,601
Net loss	-	-	-	(1,084)	-	-	(1,084)
Net change in unrealized gain on marketable securities, net of tax	-	-	-	-	290	-	290
Balance at December 31, 2016	1,684,745	1,685	3,499	(2,636)	259	-	2,807
Net income	-	-	-	2,740	-	882	3,622
Net change in unrealized loss on debt securities, net of tax	-	-	-	-	(470)	-	(470)
Restricted stock	-	-	-	-	-	209	209
Distribution	-	-	-	-	-	(51)	(51)
Foreign currency translation	-	-	-	-	(93)	-	(93)
Balance at December 31, 2017	1,684,745	1,685	3,499	104	(304)	1,040	6,024
Net Income	-	-	-	154	-	54	208
Net change in unrealized loss on debt securities, net of tax	-	-	-	-	(7)	-	(7)
Adoption of ASU 2016-01	-	-	-	(86)	86	-	-
Distribution	-	-	-	-	-	(50)	(50)
Foreign currency translation	-	-	-	-	18	-	18
Stock grants to employees	10,000	10	1	-	-	-	11
Balance at September 30, 2018	1,694,745	\$ 1,695	\$ 3,500	\$ 172	\$ (207)	\$ 1,044	\$ 6,204

See accompanying notes to consolidated financial statements

**PARAGON TECHNOLOGIES, INC.**

Consolidated Statements of Cash Flows (Unaudited)  
 For the Nine Months Ended September 30, 2018 and 2017  
 (In Thousands)

	September 30, 2018	September 30, 2017
Cash flows from operating activities:		
Net income	\$ 208	\$ 4,042
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation of real estate, machinery, equipment and software	155	95
Amortization of intangible assets	50	39
Realized gains on investments	(145)	(198)
Unrealized loss on investments	6	
Gain on sale of fixed assets	(1)	
Stock based compensation	11	209
Gain on bargain purchase	-	(4,226)
Deferred taxes	27	185
Change in operating assets and liabilities:		
Trade accounts receivables	1,380	(2,003)
Contract assets	90	139
Inventories	(319)	(1,707)
Prepaid expenses and other current assets	(851)	(581)
Accounts payable	1,485	2,376
Contract liabilities	336	846
Accrued salaries, wages and commissions	113	202
Income tax payable	(443)	(613)
Accrued product warranties	3	12
Accrued other liabilities	(443)	826
Net cash provided by (used) in operating activities	<u>1,662</u>	<u>(357)</u>
Cash flows from investing activities:		
Acquisition of SEDC, less cash acquired	-	(914)
Purchases of real estate, machinery, equipment and software	(817)	(37)
Sale of real estate, machinery, equipment and software	2	
Purchases of investments	(170)	(497)
Proceeds from sale of investments	417	939
Net cash used in investing activities	<u>(568)</u>	<u>(509)</u>
Cash flows from financing activities:		
Borrowings of amounts from bank loan - line of credit, net	(2,149)	2,637
Noncontrolling interest distribution	(50)	-
Net cash provided by (used) in financing activities	<u>(2,199)</u>	<u>2,637</u>
Effect of exchange rates on cash	17	31
Increase (decrease) in cash and cash equivalents	(1,088)	1,802
Cash and cash equivalents, beginning of period	2,040	1,733
Cash and cash equivalents, end of period	<u>\$ 952</u>	<u>\$ 3,535</u>
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest expense	<u>\$ 326</u>	<u>\$ 227</u>
Income taxes	<u>\$ 44</u>	<u>\$ 14</u>
Supplemental disclosures of noncash investing activities:		
Mark to market on available for sale securities, gross	<u>\$ (38)</u>	<u>\$ (462)</u>
Supplemental disclosures of noncash operating, investing and financing activities:		
Acquisition of business (Note 2)		

See accompanying notes to consolidated financial statements.

**(1) Description of Business and Summary of Significant Accounting Policies**

**Description of Business and Concentrations of Credit Risk**

Paragon Technologies, Inc. ("Paragon" or the "Company"), is a holding company owning subsidiaries that engage in diverse business activities including material handling, distribution, real estate and investments.

**Automation and Material Handling**

Our material handling operations are operated through our subsidiary, SI Systems, LLC. SI provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications. SI Systems' capabilities include horizontal conveyance and transportation, rapid dispensing and for order fulfillment, automatic document inserting system, a full suite of high performance Warehouse Execution Systems (WES), Warehouse Management Systems (WMS) and Warehouse Control Systems (WCS) software systems and aftermarket services. The newest addition to our material handling portfolio is the Effimat® line. Earlier this year, SI Systems was selected as a Master Distributor for North America by Effimat Storage Technology of Denmark. SI Systems' automated material handling systems are used by manufacturing, assembly, order fulfillment, and distribution operations customers located primarily in North America, including the U.S. government.

SI Systems is brought to market as two individual brands, SI Systems' Dispensing and Towline. The Dispensing business focuses on providing order fulfillment systems to distribution operations, including Dispen-SI-matic®, Mobile-Matic® (a patented product), Doc-U-spense™ automatic document inserting system and our full suite of Warehouse Execution Systems, Warehouse Management Systems and Warehouse Control Systems software solutions with our SI-IWS™ product. These systems are sold primarily through a nationwide network of authorized material handling integrators, dealers and direct to major OEM, end users and 3PL accounts. All EffiMat® products and services will be marketed with our other order fulfillment equipment. The Towline business focuses on providing automated material handling systems to manufacturing, assembly and distribution operations via our Lo-Tow® Towline horizontal conveyance and transportation technologies. These systems are sold primarily to end users.

**Distribution**

Our distribution operations are carried out through our subsidiary SED International de Colombia ("SED Colombia" or "SEDC"). SED Colombia currently distributes IT hardware products from 27 top worldwide leading manufacturers such as Hewlett Packard, Lenovo, Dell, Asus, Epson and others.

SEDC business is divided into three main business units: Value, Transactional and Integrated Services. The Value business unit focuses on enterprise sales and business projects, typically selling more specialized products that usually carry higher margins. The top products distributed by our Value unit include servers, workstations, storage, networking and power protection systems. SEDC Transactional business unit focuses on the consumer business (retail resellers) as well as run rate products for Value Added Resellers (VAR'S) selling to small and medium businesses (SMB). The top products distributed by the Transactional business unit include notebook computers, desktop computers, printers, TVs, audio/visual equipment, projectors and accessories. In July 2017, SEDC launched the Integrated Services business unit. The services provided by this business unit include business cloud services, managed services, professional IT services, infrastructure IT solutions and internet of things (IOT) solutions. The Integrated Service unit has also taken ownership of the extended warranties and maintenance agreements sales.

**Real Estate**

In December 2017, Ohana Home Services, LLC, a wholly owned subsidiary of Paragon, was established to acquire real estate for income and capital appreciation purposes. In December 2017, Paragon acquired residential real estate in Las Vegas, Nevada for \$750,000. In January 2018, Paragon transferred title of the real estate to Ohana. There was no consideration exchanged between the parties. In January 2018, Ohana acquired a second similar residential property also in Las Vegas, Nevada for \$750,000. Ohana intends to lease its real estate to generate positive cash flow for the foreseeable future and may seek to monetize its real estate holdings during favorable market conditions.

**(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)*

**Description of Business and Concentrations of Credit Risk** *(Continued)*

**Investments**

Paragon also invests in businesses and securities under the Investment Management Policy. The Investment Management Policy sets forth the parameters under which a portion of Paragon's cash balance may be invested in marketable securities, including U.S. Treasuries, equities of publicly traded companies, bonds, money market instruments and other securities. Investment decisions under the Investment Management Policy are made by Sham Gad, CEO and Chairman of the Board. The Investment Management Policy sets forth restrictions on the investment of Paragon's funds, including an aggregate limit on Paragon's cash balance that is made available for investment, limits on the amount that may be invested in any single equity or fixed income position or certain categories of securities, prohibition of short-selling, margin trading and the use of leverage, requirements for the management of the investment account, and other Board-approval requirements.

In the nine months ended September 30, 2018, one customer individually accounted for sales of 14.6%. In the nine months ended September 30, 2017, no customers accounted for over 10% of sales. No other customers accounted for over 10% of sales.

As of September 30, 2018, one customer individually owed the Company 15.2% of trade accounts receivables. As of September 30, 2017, no customers individually owed the Company greater than 10% of trade accounts receivables.

SI Systems maintains its cash and cash equivalents in a financial institution located in the United States of America. At times, cash balances may be in excess of F.D.I.C. limits. Investment balances are held in broker accounts and may be in excess of S.I.P.C. limits.

**Principles of Consolidation**

The consolidated financial statements include the accounts of Paragon Technologies, Inc. and its wholly owned subsidiaries SI Systems, LLC, (SI Systems) Ohana Home Services, LLC (Ohana) and ARK Investments, LLC (ARK). ARK owns 80% of SED International de Colombia, S.A.S.

**Use of Estimates**

The preparation of the 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 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 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, deferred tax valuation allowance and revenue recognition on fixed price contracts.

**Cash and Cash Equivalents**

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, cash on deposit, amounts invested on an overnight basis with a bank or broker/dealer and other highly liquid investments purchased with an original maturity of three months or less.

**Trade Accounts Receivable and Allowance for Doubtful Accounts**

Trade accounts receivable are stated at outstanding balances, less an allowance for doubtful accounts. For SI Systems, the allowance for doubtful accounts is determined by a specific identification of individual accounts. The Company writes off receivables upon determination that no further collections are probable. For SEDC, an allowance for doubtful accounts has been established based on collection experience and an assessment of the collectability of specific accounts. The overall determination of the allowance also considers credit insurance coverage and deductibles. SEDC maintains credit insurance, which protects the Company from credit losses exceeding certain deductibles (subject to certain terms and conditions). The allowance for doubtful accounts was \$54,877 and \$13,699 as of September 30, 2018 and 2017, respectively.

**(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)*

**Inventories**

For SI Systems, inventories primarily consist of materials purchased or manufactured for stock and are stated at the lower of cost (first-in, first-out method) or net realizable value. For SEDC, inventories consist of finished goods and are stated at the lower of cost (first-in, first-out method) or market. Certain SEDC vendors allow for either return of goods within a specified period (usually 45 - 90 days) or for credits related to price protection. However, for certain other vendors and inventories, the Company is not protected from the risk of inventory loss. Therefore, in determining the net realizable value of inventories, the Company identifies slow moving or obsolete inventories that (1) are not protected by vendor agreements from risk of loss, and (2) are not eligible for return under various vendor return programs. Based upon these factors, the Company estimates the net realizable value of inventories and records any necessary adjustments as a charge to cost of sales. If inventory return privileges were discontinued in the future, or if vendors were unable to honor the provisions of certain contracts which protect SEDC from inventory losses, including price protections, the risk of loss associated with obsolete, slow moving or impaired inventories would increase.

**Marketable Securities**

The Company adopted ASU 2016-01 on January 1, 2018. The standard primarily affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. The Company reclassified \$86,000 between other comprehensive income and retained earnings due to the adoption of ASU 2016-01.

The Company's marketable securities portfolio is designated as available-for-sale. 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. Previous to the adoption of ASU 2016-01, unrealized gains and losses on all securities were reported as increases or decreases in other comprehensive income (loss). With the adoption of ASU 2016-01 as of January 1, 2018, the Company now recognizes the change in the value of equity securities in its current period income statement. For the three months and the nine months ended September 30, 2018, the Company recognized an unrealized loss of (\$4,493) and (\$5,431), respectively, due to the closing trade price on that date. Unrealized gains and losses on debt securities continue to be reported as increases or decreases in other comprehensive income (loss). 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 nine months ended September 30, 2018 and 2017.

**(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)*

**Marketable Securities** *(Continued)*

The amortized cost and approximate fair value of marketable securities available-for-sale as of September 30, 2018 and December 31, 2017 are summarized as follows *(in thousands)*:

	Equity Securities			
	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018	\$115	\$ 19	\$ 25	\$109
December 31, 2017	239	152	10	381

  

	Debt Securities			
	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018	\$555	\$0	\$384	\$171
December 31, 2017	555	0	516	39

  

	Total Marketable Securities			
	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018	\$670	\$19	\$409	\$280
December 31, 2017	794	152	526	420

At September 30, 2018, the Company had one debt security in an unrealized loss position for less than twenty-seven months and five equity securities in an unrealized loss position for less than three 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. 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.



**(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)*

**Marketable Securities** *(Continued)*

*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.

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, 2018 and December 31, 2017 are as follows *(in thousands)*:

	Marketable Securities			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
As of September 30, 2018	\$280	\$ 280	\$ -	\$ -
As of December 31, 2017	420	420	-	-

**Investment in Real Estate**

In December 2017, Ohana was established to acquire real estate for income and capital appreciation purposes. In December 2017, Paragon acquired residential real estate in Las Vegas, Nevada for \$750,000. In January 2018, Paragon transferred title of the real estate to Ohana. There was no consideration exchanged between the parties. In January 2018, Ohana acquired a second similar residential property also in Las Vegas, Nevada for \$750,000. Ohana intends to lease its real estate to generate positive cash flow for the foreseeable future and may seek to monetize its real estate holdings during favorable market conditions.

**Fixed Assets**

Real estate, machinery, equipment and software acquired in business combinations are recorded at fair value; additions are recorded at cost. Machinery, equipment and software are depreciated on the straight-line method over the estimated useful lives of individual assets. The Company capitalizes costs incurred to develop commercial software products or enhancements to software products where such enhancement extends the life of the products. The ranges of lives used in determining depreciation rates for machinery and equipment and software is generally 3 - 7 years and 15 years for real estate. Maintenance and repairs are charged to operations; betterments and renewals are capitalized. Upon sale or retirement of machinery and equipment, the cost and related accumulated depreciation are removed from the accounts and the resultant gain or loss, if any, is credited or charged to earnings.

**Intangible Assets**

As a result of the acquisition of SEDC in 2017, intangible assets of a trade name and customer relationships were recognized at fair value. The details of the intangible assets and the related amortization are shown in Note 5 to the consolidated financial statements.

**(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)*

**Impairment of Long Lived Assets**

The Company reviews the recovery of the net book value of long-lived assets whenever events and circumstances indicate that the net book value of an asset may not be recoverable. In cases where undiscounted expected future cash flows are less than the net book value, an impairment loss is recognized equal to an amount by which the net book value exceeds the fair value of assets. There were no impairments noted in 2018 or 2017.

**Foreign Currency Translation**

The financial statements of the foreign operations are measured in their local currency and then translated to U.S. dollars. All balance sheet accounts have been translated using the current rate of exchange at the balance sheet date or historical rates of exchange, as applicable. Results of operations have been translated using the average monthly exchange rates. Translation gains or losses resulting from the changes in exchange rates from year to year are accumulated in a separate component of stockholders' equity and are reported in the consolidated statements of comprehensive income (loss). Realized foreign currency transaction gains and losses are included in the accompanying consolidated statements of operations.

**Revenue and Cost Recognition**

SI recognizes revenue from contracts with customers under Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2014-09, "*Revenue from Contracts with Customers (Topic 606)*." The primary revenue sources for SI Systems are from fixed price system contracts, sales of parts or equipment and individual support service contracts.

SI recognizes revenue using the following steps:

1. Identification of the contract with a customer;
2. Identification of the performance obligations in the contract;
3. Determination of the transaction price;
4. Allocation of the transaction price to the performance obligations in the contract; and
5. Recognition of revenue when, or as, performance obligations are satisfied.

Revenue on a significant portion of SI Systems contracts is currently recognized using a cost-to-cost method based on the continuous transfer of control to the customer over time. SI transfers control for the system contracts, in two ways: (1) SI's performance creates or enhances an asset that the customer controls as the customized asset is created or enhanced for our Towline brand and (2) SI has an enforceable right to payment for both our Towline and Dispensing brands. The entire contract is the performance obligation. Typically, we would not sell the design, implementation and installation individually. The customer would not benefit from the individual good or service on its own. There is no alternative use for the customer.

The Company accounts for system contracts on an over time basis, electing an input method of estimated costs as a measure of performance completed. The selection of the measurement of progress using estimated costs was based on a thorough consideration of alternatives of various output and input measures, including contract milestones and labor hours. However, the Company has determined that other input and output measures are not an appropriate measure of progress as they do not accurately align with the transfer of control on its customized product solutions. The selection of costs incurred as a measure of progress aligns the transfer of control to the overall production of the customized system.

For systems contracts accounted for over time using estimated costs as a measure of performance completed, the Company relies on the estimates around the total estimated costs to complete the contract ("Estimated Costs at Completion"). Total Estimated Costs at Completion include direct labor, material and subcontracting costs. Due to the nature of the efforts required to be performed to meet the underlying performance obligation, determining Estimated Costs at Completion may be complex and subject to many variables. We have a standard and disciplined quarterly process in which management reviews the progress and performance of open contracts in order to determine the best estimate of Estimated Costs at Completion. As part of this process, management reviews information including, but not limited to, any outstanding key contract matters, progress towards completion, the project schedule, identified risks and opportunities, and the related changes in estimates of costs. The risks and opportunities include management's judgment about the ability and cost to achieve the project schedule, technical requirements, and other contract requirements. Management must make assumptions and estimates regarding

**(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)*

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

labor productivity and availability, the complexity of work to be performed, the availability and cost of material, and performance by subcontractors, among other variables. Based on this analysis, any quarterly adjustment to net sales, cost of sales, and the related impact on operation income are recorded as necessary in the period they become known. When estimates of total costs to be incurred on a contract exceed estimates of total revenue to be earned, a provision for the entire loss on the contract is recorded in the period in which the loss is determined.

Payment terms for system contracts include an initial payment at the time the contract is executed, with future payments dependent upon the completion of certain contract phases or targeted milestones. In the event of contract cancellation, SI Systems is entitled to payment for all work performed through the point of cancellation. Likewise, in the event of contract cancellation prior to earning revenue equal to or greater than the initial payment, SI Systems is generally not required to refund the unused portion.

For SI's revenue for sales of parts or equipment, the contract is the customer purchase order that outlines the transaction price. The performance obligation is the shipment of the products ordered by the customer, which aligns with SI's standard sales terms that title to the goods transfer to the customer upon shipment of the items. Based on the simplified nature of these contracts, total revenue related to the sale is attributable to the satisfaction of the performance obligation, which occurs upon shipment.

For SI's revenue for individual support services, the contract is the customer purchase order that outlines the transaction price. Support contracts are prepaid and typically cover a one-year period. Revenue is recognized ratably over the course of the contract term. SI is entitled to payment regardless of what level of support is required and regardless of the outcome. The performance obligation is related to the promise to have a resource available. SI analyzed the software support percentage of cost to revenue monthly, quarterly and annually for the three years ended December 31, 2017, 2016 and 2015. SI found consistency year over year in the annual percentage of cost to revenue. There were fluctuations month to month and quarter to quarter, but that can happen depending on the customer's needs and depth of support. Therefore, due to the unpredictable fluctuations, SI determined support service (in the form of availability to the customer) is provided over the life of the contract and revenue should be recognized accordingly.

SEDC recognizes revenue from contracts with customers under Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") 2014-09, "*Revenue from Contracts with Customers (Topic 606)*." The primary revenue source for SEDC revenue is distribution of IT hardware products.

SEDC recognizes revenue using the following steps:

1. Identification of the contract with a customer;
2. Identification of the performance obligations in the contract;
3. Determination of the transaction price;
4. Allocation of the transaction price to the performance obligations in the contract; and
5. Recognition of revenue when, or as, performance obligations are satisfied.

SEDC's revenues primarily result from the sale of various technology products and services. SEDC recognizes revenue as control of products is transferred to customers, which generally happens upon shipment. Products sold by SEDC are delivered via shipment from SEDC's facilities, or by electronic delivery of keys for non-hardware products. SEDC considers customer purchase orders, which in some cases are governed by master agreements, to be the contracts with a customer. All revenue is generated from contracts with customers.

Revenues from integrated services contracts, which are performed over time, and related contract liabilities were not material for the periods presented.

**PARAGON TECHNOLOGIES, INC.**  
Notes To Consolidated Financial Statements

**(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)*

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

The Company considers shipping as costs to fulfill the sales of products. Shipping revenue is included in net sales when control of the product is transferred to the customer, and the related shipping costs are included in cost of products sold.

Taxes imposed by governmental authorities on the Company's revenue producing activities with customers, such as value added tax, are excluded from net sales.

The Company disaggregates our revenue from contracts with customers by geographic location, major product lines and timing of revenue recognition. See details in the tables below for the three months and the nine months ended September 30, 2018.

	Three Months Ended September 30, 2018				
	Automation/				
Disaggregation of Total Net Sales (in thousands)	Material Handling	Distribution	Real Estate		Total
<b>Primary Geographical Markets</b>					
North America	\$ 2,528	-	\$ 26		\$ 2,554
Latin America	-	18,439	-		18,439
Europe & Asia	3	-	-		3
<b>Total Net Sales</b>	<b>\$ 2,531</b>	<b>\$ 18,439</b>	<b>\$ 26</b>		<b>\$ 20,996</b>
<b>Major Goods/Service Lines</b>					
Material handling systems	1,964	-	-		\$ 1,964
Software support	175	-	-		175
Parts & equipment	392	-	-		392
Transactional	-	15,764	-		15,764
Value	-	2,495	-		2,495
Services	-	180	-		180
Residential real estate rental income	-	-	26		26
<b>Total Net Sales</b>	<b>\$ 2,531</b>	<b>\$ 18,439</b>	<b>\$ 26</b>		<b>\$ 20,996</b>
<b>Timing of Revenue Recognition</b>					
Goods transferred at a point in time	393	18,429	-		\$ 18,822
Goods & services transferred over time	2,138	10	26		2,174
<b>Total Net Sales</b>	<b>\$ 2,531</b>	<b>\$ 18,439</b>	<b>\$ 26</b>		<b>\$ 20,996</b>

**PARAGON TECHNOLOGIES, INC.**  
Notes To Consolidated Financial Statements

**(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)*

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

	Nine Months Ended September 30, 2018			
Disaggregation of Total Net Sales (in thousands)	Automation/ Material Handling	Distribution	Real Estate	Total
<b>Primary Geographical Markets</b>				
North America	\$ 4,967	-	\$ 66	\$ 5,033
Latin America	12	54,883	-	54,895
Europe & Asia	197	-	-	197
<b>Total Net Sales</b>	<b>\$ 5,176</b>	<b>\$ 54,883</b>	<b>\$ 66</b>	<b>\$ 60,125</b>
<b>Major Goods/Service Lines</b>				
Material handling systems	3,325	-	-	3,325
Software support	554	-	-	554
Parts & equipment	1,297	-	-	1,297
Transactional	-	45,266	-	45,266
Value	-	8,494	-	8,494
Services	-	1,123	-	1,123
Residential real estate rental income	-	-	66	66
<b>Total Net Sales</b>	<b>\$ 5,176</b>	<b>\$ 54,883</b>	<b>\$ 66</b>	<b>\$ 60,125</b>
<b>Timing of Revenue Recognition</b>				
Goods transferred at a point in time	1,298	54,861	-	56,159
Goods & services transferred over time	3,878	22	66	3,966
<b>Total Net Sales</b>	<b>\$ 5,176</b>	<b>\$ 54,883</b>	<b>\$ 66</b>	<b>\$ 60,125</b>

*Contract Balances (in thousands)*

	September 30, 2018	December 31, 2017
Receivables	\$ 11,263	\$ 12,643
Contract assets	\$ 0	\$ 90
Contract liabilities	\$ 1,455	\$ 1,119

Contract assets consist of amounts formerly classified as costs and estimated earnings in excess of billings where the Company does not yet have an unconditional right to bill. Contract liabilities consist of amounts formerly classified as Billings in excess of costs and estimated earnings and unearned support contract revenue.

Payment terms on system contracts are typically tied to implementation milestones associated with progress on contracts while revenue recognition is over-time based on a cost-to-cost method of measuring performance. The Company may recognize a contract asset or contract liability, depending on whether revenue has been recognized in excess of billings or billings in excess of revenue. The Company does not record a financing component to contracts when it expects, at contract inception that the period between the transfer of a promised good or service and related payment terms are less than a year, applying practical expedients available under the accounting standards.

**(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)*

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

Revenue recognized during the three and nine months ended September 30, 2018, which was previously included in Contract liabilities as of December 31, 2017, is \$185 and \$1,002, respectively *(in thousands)*.

There have been no impairment losses recognized on customer receivables or contract assets during the nine months ended September 30, 2018.

SI Systems 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.

**Unearned Support Contract Revenue**

SI Systems 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 SI Systems products are installed. As part of its support contracts, SI Systems 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.

SI Systems records advance payments for unearned support contracts in the balance sheet as a contract 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. Refer to Revenue and Cost Recognition above for more information.

**Product Development Costs**

The Company expenses product development costs as incurred.

**Accrued Product Warranty**

SI Systems 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. SI Systems 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
2018.....	\$ 89	\$ 64	\$ 61	\$ 92
2017.....	67	12	-	79

**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.

**(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)*

**Income Taxes** *(Continued)*

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.

U.S. Tax Reform: The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act reduces the U.S. federal corporate tax rate from 35% to 21%, requires companies to record and pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings.

As of December 31, 2017, the Company remeasured certain deferred tax assets and liabilities based on the federal rate at which they are expected to reverse in the future, which is generally 21%. The Company also remeasured the state rate at which certain deferred tax assets and liabilities are expected to reverse in the future associated with the reduction in the future federal benefit from state deferred tax assets and liabilities from 35% to 21%. The amount recorded related to the remeasurement of the Company's deferred tax balance was recorded to the deferred balances with an offset to the deferred tax allowance.

The one-time transition tax is based on the Company's total post-1986 earnings and profits ("E&P") that were previously deferred from U.S. income taxes. The Company recorded a liability of \$46 *(in thousands)* for the one-time transition tax for its foreign subsidiaries.

The Company has not yet made a policy election with respect to its treatment of potential global intangible low-taxed income ("GILTI") which will be required for fiscal year 2018. Companies can either account for taxes on GILTI as incurred or recognize deferred taxes when basis differences exist that are expected to affect the amount of the GILTI inclusion upon reversal. The Company is still in the process of analyzing the provisions of the Act associated with GILTI and the expected impact of GILTI on the Company in the future.

SI is subject to U.S. federal income tax as well as income tax of multiple state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state, and local income tax examinations by tax authorities for years before 2014.

SEDC is no longer subject to income tax examinations for tax years ended before December 31, 2012. However, management and its tax advisors estimate that no significant differences may result from such contingent examinations that justify any additional accrual to cover the possibility of any expenses deemed as not allowed by the local tax authority.

**Stock-Based Compensation**

The Company has a stock-based compensation plan in place and records the associated stock-based compensation expense over the requisite service period. Restricted stock awards that are service-based are recorded as equity and amortized into compensation expense on a straight-line basis over the vesting period. These stock-based compensation plans and related compensation expense are discussed more fully in Note 6 to the consolidated financial statements.

**Earnings Per Share**

Basic and diluted earnings per share for the three and the nine months ended September 30, 2018, and 2017 are based on the weighted average number of shares outstanding.

**PARAGON TECHNOLOGIES, INC.**  
Notes To Consolidated Financial Statements

**(2) Acquisition Information**

**SED International de Colombia S.A.S.**

On October 17, 2016, Ark Investments, LLC was formed as a wholly owned subsidiary of Paragon Technologies, Inc. On March 1, 2017, Ark Investments, LLC acquired SED International de Colombia, S.A.S. (SEDC), a Colombian based company, for a purchase price of \$1,395,000. SEDC distributes computer and technology systems in Colombia and Latin America. The Company purchased all the outstanding capital stock with cash. Operations of SEDC for 2017 are included from the acquisition date of March 1, 2017 in the consolidated statement of income.

SEDC was an attractive acquisition target to Paragon because of its business model and consistent earnings stream. Prior to the acquisition date, SEDC's parent company, SED International Holdings, Inc., had filed for protection under the U.S. bankruptcy regulations. The U.S. Bankruptcy Court approved bidding procedures related to the sale of SEDC in December of 2016 and then approved the purchase of SEDC by Ark Investments, LLC in February, 2017. The SEDC acquisition resulted in a bargain purchase and a gain was recorded in other income of \$4,226,089.

Intangible assets of \$672,229 were recognized at fair value and are composed of trade name of \$536,690 and customer relationships of \$135,539. The weighted average useful life of the intangible assets is 10 years.

The allocated fair value of assets acquired and liabilities assumed is summarized as follows (*in thousands*):

Cash	\$ 481
Trade accounts receivables	8,289
Inventories	9,713
Prepaid and other assets	4,176
Software and equipment	280
Deferred taxes	119
Intangible assets	672
Total assets acquired	<u>23,730</u>
Credit lines	4,798
Accounts payable	11,292
Accrued other liabilities	1,208
Income taxes payable	811
Total liabilities assumed	<u>18,109</u>
Total identified net assets acquired	5,621
Bargain purchase gain	<u>(4,226)</u>
	<u>\$ 1,395</u>

All acquisition related costs, including legal, professional, and other expenses, were expensed by the Company in the period incurred and not included in the purchase price. Acquisition costs are included in selling, general and administrative expenses on the consolidated statement of operations and were approximately \$3,000 and \$48,000, respectively, for the three months and the nine months ended September 30, 2017. There were no acquisition costs for the three months and the nine months ended September 30, 2018.



**PARAGON TECHNOLOGIES, INC.**  
Notes To Consolidated Financial Statements

**(3) Segment Information**

Segment information for the nine months ended September 30, 2018 is as follows (*in thousands*):

Nine Months Ended September 30, 2018	Automation/ Material Handling	Distribution	Real Estate	Investments	Eliminations	Consolidated
Net Sales to unaffiliated customers	\$ 5,176	\$ 54,883	\$ 66	\$ -	\$ -	\$ 60,125
Gross Profit	1,499	3,979	66	-	-	5,544
Operating income (loss)	(180)	835	(41)	-	-	614
Foreign Currency transaction gain (loss)	-	20	-	-	-	20
Interest expense, net	(49)	(261)	-	-	18	(292)
Interest income	-	29	-	10	(18)	21
Investment income	-	-	-	139	-	139
Income tax expense	11	264	-	-	-	275
Net income (loss) attributable to Paragon Technologies, Inc. and subsidiaries	(170)	217	(41)	148	-	154
Total assets at September 30, 2018	\$ 4,468	\$ 31,855	\$ 1,487	\$ 280	\$ (7,110)	\$ 30,980

The domestic segments include automation/material handling, real estate and investments. The foreign segment is distribution.

**(4) Line of Credit**

During 2018 and 2017, the Company had a \$750,000 line of credit facility with its principal bank to be used primarily for working capital purposes. The line of credit facility contains various non-financial covenants and is secured by all of the Company's trade accounts receivables and inventories. The availability on the line of credit was \$125,000 as of September 30, 2018. Interest on the line of credit facility is based on the "Wall Street Journal Prime Rate" plus 1.00%. The outstanding borrowings were \$625,000 and \$350,000 as of September 30, 2018 and December 31, 2017, respectively.

During 2018 and 2017, the Company had a \$945,000 line of credit facility with its marketable securities broker to be used primarily for general business purposes. The line of credit facility is secured by the available securities in the account. The availability on the line of credit was approximately \$945,000 as of September 30, 2018. Interest on the line of credit facility is based on the one (1) month Libor rate plus 225 bps. The outstanding borrowings were \$0 and \$708,000 as of September 30, 2018 and December 31, 2017, respectively.

During 2017, the Company had a \$1,500,000 line of credit facility with its principal bank to be used primarily for working capital needs associated with large long-term contracts. The line of credit facility was not renewed at its expiration in November 2017.

SEDC currently maintains short term working capital lines of credit at four local banks. Below is a detail of these lines as of September 30, 2018 and December 31, 2017, respectively.

**PARAGON TECHNOLOGIES, INC.**  
Notes To Consolidated Financial Statements

**(4) Line of Credit (Continued)**

<b>September 30, 2018</b>			<u>Line of credit</u>		<u>Borrowings</u>		<u>Availability</u>	
Bank Name	Currency	Rate	in '000 pesos	in USD	in '000 pesos	in USD	in '000 pesos	in USD
Davivienda	Local	IBR+4.116	1,505,000	506,362	1,503,333	505,802	1,667	560
Bancoomeva	Local	DTF+5	2,000,000	672,907	2,000,000	672,907	0	0
Bancolombia	USD	DTF+2.6	1,407,268	473,480	1,283,475	431,829	123,792	41,651
de Occidente	Local	7%	1,341,124	451,226	1,286,702	432,915	64,423	18,311
			<u>6,253,392</u>	<u>2,103,975</u>	<u>6,073,510</u>	<u>2,043,453</u>	<u>179,883</u>	<u>60,522</u>

  

<b>December 31, 2017</b>			<u>Line of credit</u>		<u>Borrowings</u>		<u>Availability</u>	
Bank Name	Currency	Rate	in '000 pesos	in USD	in '000 pesos	in USD	in '000 pesos	in USD
Davivienda	Local	IBR+4.3	2,200,000	740,000	2,200,000	740,000	0	0
Bancoomeva	Local	DTF+5	2,000,000	670,000	2,000,000	670,000	0	0
Bancolombia	USD	DTF+2.7	5,222,000	1,750,000	4,931,898	1,650,000	290,102	100,000
de Occidente	Local	IBR+5	1,491,000	500,000	840,000	280,000	651,000	220,000
			<u>10,913,000</u>	<u>3,660,000</u>	<u>9,971,898</u>	<u>3,340,000</u>	<u>941,102</u>	<u>320,000</u>

SEDC also has an accounts receivable factoring credit arrangement with two local banks as of September 30, 2018 and one local bank as of December 31, 2017, respectively. Below is the detail of the arrangement.

<b>September 30, 2018</b>		<u>AR factoring arrangement</u>		<u>Borrowings</u>		<u>Availability</u>	
Bank Name	Rate	in '000 pesos	in USD	in '000 pesos	in USD	in '000 pesos	in USD
de Occidente	TBD	4,000,000	1,345,814	0	0	4,000,000	1,345,814
AV Villas	DTF+2.5	4,500,000	1,514,040	3,612,243	1,215,351	887,757	298,689
		<u>8,500,000</u>	<u>2,859,854</u>	<u>3,612,243</u>	<u>1,215,351</u>	<u>4,887,757</u>	<u>1,644,503</u>

  

<b>December 31, 2017</b>		<u>AR factoring arrangement</u>		<u>Borrowings</u>		<u>Availability</u>	
Bank Name	Rate	in '000 pesos	in USD	in '000 pesos	in USD	in '000 pesos	in USD
de Occidente	IBR+3.8	2,000,000	670,000	2,000,000	670,000	0	0
		<u>2,000,000</u>	<u>670,000</u>	<u>2,000,000</u>	<u>670,000</u>	<u>0</u>	<u>0</u>

The rates that are TBD have no current borrowing activity. The rates are established at time of borrowing

SEDC also has revolving credit agreements for factoring accounts payable from HP Inc., Lenovo and Epson with 2 local banks as of September 30, 2018 and three local banks as of December 31, 2017, respectively. The factoring arrangements allow for 74 to 77 days' payment terms at 0% interest rate. If the 74 to 77 days are exceeded, interest will be charged at the prevailing market rate for the excess period.

<b>September 30, 2018</b>		<u>AP factoring agreement</u>		<u>Borrowings</u>		<u>Availability</u>	
Bank Name		in '000 pesos	in USD	in '000 pesos	in USD	in '000 pesos	in USD
Bancolombia		5,500,001	1,850,494	0	0	5,500,001	1,850,494
De Occidente		5,358,876	1,803,012	5,358,876	1,803,012	0	0
		<u>10,858,877</u>	<u>3,653,506</u>	<u>5,358,876</u>	<u>1,803,012</u>	<u>5,500,001</u>	<u>1,850,494</u>

  

<b>December 31, 2017</b>		<u>AP factoring agreement</u>		<u>Borrowings</u>		<u>Availability</u>	
Bank Name		in '000 pesos	in USD	in '000 pesos	in USD	in '000 pesos	in USD
Bancolombia		5,492,000	1,840,000	3,049,058	1,022,000	2,442,942	118,000
BBVA		1,500,000	503,000	829,691	278,000	670,309	225,000
De Occidente		4,509,000	1,511,000	4,379,655	1,468,000	129,345	43,000
		<u>11,501,000</u>	<u>3,854,000</u>	<u>8,258,404</u>	<u>2,768,000</u>	<u>3,242,596</u>	<u>1,086,000</u>

**(5) Intangible Assets**

**PARAGON TECHNOLOGIES, INC.**  
Notes To Consolidated Financial Statements

Intangible assets are as follows *(in thousands)*:

	September 30, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Trade name .....	\$ 537	\$ 85	\$ 452
Customer Relations .....	135	21	114
	<u>\$ 672</u>	<u>\$ 106</u>	<u>\$ 566</u>
	December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Trade name .....	\$ 537	\$ 45	\$ 492
Customer Relations .....	135	11	124
	<u>\$ 672</u>	<u>\$ 56</u>	<u>\$ 616</u>

**(6) Stock Options and Non-Vested Stock**

**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 were 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. On September 18, 2013, the Board of Directors increased the number of shares of common stock available for grant under the Plan to 350,000 shares.

During the nine months ended September 30, 2018, 10,000 shares were granted to an employee. Stock-based compensation expense recognized during the nine months ended September 30, 2018 for stock-based compensation programs was \$11,400 for employee stock grants. All of the stock-based compensation expense was a component of selling, general and administrative expenses. There were no stock options granted for the nine months ended September 30, 2018 and 2017.

The Company estimates the fair value of stock options on the grant date by applying the Black-Scholes option pricing valuation model. The application of this valuation model involved assumptions that are highly subjective, judgmental, and sensitive in the determination of compensation cost.

**Restricted Stock – Non-controlling Interest**

The Company was party to an agreement to grant a 20% noncontrolling interest (NCI) in SEDC to El-Gibhor, an entity controlled by Mr. Ronell Rivera, President of SEDC. The acquisition date fair value of the NCI was \$209,250. The fair value of the NCI was calculated by taking 20% of the fair value of the total consideration less a 25% discount for lack of control. Total compensation expense for the nine months ended September 30, 2018 and 2017 related to the NCI was \$0 and \$209,250, respectively. As of December 31, 2017, El-Gibhor is fully vested in the 20% NCI.

**Chairman's Compensation and Directors' Fees Paid**

For 2017, Mr. Gad was paid \$150,000 in cash for his roles as chairman of the board and director. The other directors were paid \$36,000 in cash in four equal quarterly installments in advance of each quarter.

**PARAGON TECHNOLOGIES, INC.**  
Notes To Consolidated Financial Statements

**(6) Stock Options and Non-Vested Stock** (Continued)

**Chairman's Compensation and Directors' Fees Paid (continued)**

For 2018, Mr. Gad as chairman and director is expected be paid the same fees as stated above for 2017. For 2018, the other directors are also expected to be the paid the same fees as stated above for 2017.

As of December 2017, Mr. Gad began serving as Interim CEO of SI Systems, LLC, a subsidiary of the Company. In that role, Mr. Gad receives compensation of \$4,000 every two weeks and, for the nine months ended September 30, 2018, his total compensation as CEO of SI Systems totaled \$76,000.

**(7) Employee Benefit Plans**

The Company has a defined contribution Retirement Savings Plan for its U.S. employees. Employees age 21 and above are eligible to participate in the Plan. Effective March 30, 2009, Company contributions under the Company's Retirement Savings Plan were suspended for an indefinite period of time as part of a cost-reduction initiative. Effective August 14, 2015, Company contributions have been reinstated. The matching contribution for the nine months ended September 30, 2018 and 2017 was \$15,855, and \$36,130, respectively. The Plan also contains provisions for profit sharing contributions in the form of cash as determined annually by the Company's Board of Directors. There was no profit sharing contributions for the nine months ended September 30, 2018 and 2017. Total expense for the Retirement Savings Plan, including Plan expenses, was \$15,855 and \$36,655 for the nine months ended September 30, 2018, and 2017, respectively.

**(8) Income Taxes**

The provision for income tax expense (benefit) consists of the following (*in thousands*):

		For the Nine months Ended September 30, 2018	For the Nine Months Ended September 30, 2017
Federal:	current	\$ 1	\$ (61)
	deferred	-	-
		<u>1</u>	<u>(61)</u>
State:	current	-	(13)
	deferred	-	-
		<u>-</u>	<u>(13)</u>
Foreign:	current	274	171
	deferred	-	-
		<u>274</u>	<u>171</u>
		<u>\$ 275</u>	<u>\$ 97</u>

The Company had no federal net operating losses at December 31, 2017. The Company had state net operating losses of approximately \$2,623 (in thousands) at December 31, 2017, expiring at 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 SI Systems domestic deferred tax assets are more likely than not to

**(8) Income Taxes (Continued)**

expire before SI Systems 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 December 31, 2017 and 2016. There is a deferred tax asset of \$125 and \$125 (in thousands) on SEDC as of September 30, 2018 and December 31, 2017, respectively.

**(9) Contingencies**

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. On March 27, 2017, John A. Harrell filed a lawsuit against SI Systems in the United States District Court for the District of Delaware regarding alleged breaches of a Stock Purchase Agreement between Mr. Harrell and SI Systems, dated on or about April 15, 2013. The parties settled the matter on December 28, 2017, and the case was dismissed by the Court with prejudice pursuant to the terms of that settlement on January 8, 2018. All expenses related to the settlement have been included in the selling, general and administrative expenses for the year ended December 31, 2017. There are no pending actions as of September 30, 2018.

**(10) Commitments**

SI Systems leases a facility located at 101 Larry Holmes Drive in Easton, Pennsylvania. The area covered by the lease is 9,648 square feet. The leasing agreement requires fixed monthly payments of \$13,500 for the final thirty-nine months through April 30, 2020 when the lease expires. Total rental expense for the nine months ended September 30, 2018, and 2017 approximated \$159,694 and \$158,200, respectively.

SED Colombia leases a 32,000 square foot facility in Chia (Cundinamarca), Colombia. The center, located near Bogotá, the capital city of Colombia, serves as a sales and administrative office and distribution facility for SEDC. The lease expired in October 2018. The contract has not been extended; however, we anticipate entering into a month-to-month agreement. The monthly payment is the equivalent of approximately \$10,629.

SEDC also leases office space in Palmetto Bay, Florida, for a monthly payment of \$1,362 (the lease expires at the end of March 2019) and two apartments in Chia for use by its two members of the management team based out of Miami, Florida, for an aggregate monthly payment of the equivalent of approximately \$970. These leases expire in mid July 2019 and end of March 2019, respectively.

Future minimum rental commitments at September 30, 2018 are as follows (in thousands):

	Operating Leases		
	SI Systems	SEDC	Total
2018	\$ 41	\$ 18	\$ 59
2019	162	6	168
2020	54	-	54
Total	\$ 257	\$ 24	\$281

**(11) Stock Repurchase Program**

On May 14, 2015, the Company's board of directors approved a program to repurchase up to \$250,000 of its outstanding stock. There were no stock repurchases during the nine months ended September 30, 2018 and 2017.

**(12) Recently Issued Accounting Pronouncements**

In August 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-15, *Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments*. This ASU was intended to clarify the presentation of cash receipts and payments in specific situations. The amendments in this update were effective for financial statements issued for annual periods beginning after December 15, 2017, including interim periods

## **12) Recently Issued Accounting Pronouncements (Continued)**

within those annual periods. The Company adopted this standard in 2018 with no material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The guidance in the ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. ASU 2016-02 initially required a modified retrospective transition method under which entities would initially apply Topic 842 at the beginning of the earliest period presented in the financial statements. Recently ASU 2018-11 added an additional optional transition method allowing entities to apply Topic 842 as of the adoption date and to recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company intends to use the optional transition method. The Company has reviewed existing leases and continues to evaluate the impact of ASU 2016-02. The Company's adoption of ASU No. 2016-02 is not expected to have a material impact on the Company's financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10)*. The standard primarily affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, the standard clarifies guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The standard was effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted this standard in 2018 with no material impact on the Company's financial statements. The Company reclassified \$86,000 between other comprehensive income and retained earnings due to the adoption of ASU 2016-01.

In November 2015, the FASB issued ASU 2015-17, *Balance Sheet Classification of Deferred Taxes*, which amends existing guidance on income taxes to require the classification of all deferred tax assets and liabilities as non-current on the balance sheet. The Company was required to adopt this ASU no later than January 1, 2018, with early adoption permitted and the guidance could be applied either prospectively or retrospectively. The Company adopted this standard in 2018 with no material impact on the Company's consolidated financial statements.

In May 2014, FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 supersedes SEC Staff Accounting Bulletin Topic 13, "*Revenue Recognition*," and ASC 605, "*Revenue Recognition Multiple-Element Arrangements*", which was the guidance previously followed by the Company. The new revenue standard's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The statement was effective for public entities for annual periods beginning after December 15, 2017.

The Company adopted ASU 2014-09, "Revenue from Contracts with Customers", and all the related amendments (collectively "ASC 606") on January 1, 2018, using the full retrospective method that restates prior period financial statements presented.

**12) Recently Issued Accounting Pronouncements (Continued)**

The restated changes made to our consolidated opening balance sheet as January 1, 2018 due to the full retrospective method of adoption of ASC 606 are as follows:

*In thousands*

	December 31, 2017 before Restatement (Audited)	Reclassification of Contract Assets	Reclassification of Contract Liabilities	December 31, 2017 After Restatement (Unaudited)
Contract assets	\$ -	\$ 90	\$ -	\$ 90
Costs and estimated earnings in excess of billings	90	(90)	-	-
Contract Liabilities	-	-	1,119	1,119
Billings in excess of costs and estimated earnings	733	-	(733)	-
Unearned support contract revenue	\$ 386	\$ -	\$ (386)	\$ -

**(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, 2018, have been evaluated through November 7, 2018, the date which these financial statements were available to be issued.