



**QUARTERLY REPORT  
FOR THE PERIOD ENDED  
SEPTEMBER 30, 2013**

**PARAGON TECHNOLOGIES, INC.**

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600 Kuebler Road  
Easton, PA 18040  
Telephone: 610-252-3205  
Fax: 610-252-3102

**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**

**1,678,595 Shares Issued and Outstanding  
as of the Filing of this Quarterly Report**

**PARAGON TECHNOLOGIES, INC.**

**Quarterly Report**

For the Period Ended September 30, 2013

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

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

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

Company Headquarters

Paragon Technologies, Inc.

600 Kuebler Road

Easton, PA 18040

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.

600 Kuebler Road

Easton, PA 18040

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: 1,678,595

Transfer Agent

American Stock Transfer & Trust Company

6201 15th Avenue

Brooklyn, NY 11219

Phone: (718) 921-8206

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

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**4) Issuance History:**

List below any events, in chronological order, that resulted in changes in total shares outstanding by the issuer in the past two fiscal years and any interim period. The list shall include all offerings of securities, whether private or public, and all shares or any other securities or options to acquire such securities issued for services, describing (1) the securities, (2) the persons or entities to whom such securities were issued, and (3) the services provided by such persons or entities. The list shall indicate:

- A. The nature of each offering (e.g., Securities Act Rule 504, intrastate, etc.);  
Private placement under Rule 506 of the Securities Act of 1933 on September 4, 2012.
- B. Any jurisdictions where the offering was registered or qualified;  
Not Applicable.
- C. The number of shares offered;  
81,000 Shares.
- D. The number of shares sold;  
81,000 Shares.
- E. The price at which the shares were offered, and the amount actually paid to the issuer;  
The shares were sold at \$2.50 per share and were fully paid in cash.
- F. The trading status of the shares; and  
The shares were issued as restricted stock under the Securities Act of 1933.
- G. Whether the certificates or other documents that evidence the shares contain a legend (1) stating that the shares have not been registered under the Securities Act, and (2) setting forth or referring to the restrictions on transferability and sale of the shares under the Securities Act.  
Yes. These legends were removed after the expiration of one year from the date the shares were purchased.

With respect to private offerings of securities, the list shall also indicate the identity of the persons who purchased securities in such private offering; *provided, however*, that in the event that any such person is an entity, the list shall also indicate (a) the identity of each natural person beneficially owning, directly or indirectly, more than ten percent (10%) of any class of equity securities of such entity and (b) to the extent not otherwise disclosed, the identity of each natural person who controlled or directed, directly or indirectly, the purchase of such securities for such entity.

<u>Name</u>	<u>Shares</u>
Derek Bork	5,000
Shaun E. Hayes	76,000

**5) Financial Statements:**

The financial statements for the three months ended September 30, 2013 are incorporated by reference and can be found at the end of this Quarterly Report. The financial statements as of and for the period ended September 30, 2013 include: (1) consolidated balance sheets, (2) consolidated statements of operations, (3) consolidated statements of comprehensive income (loss), (4) consolidated statements of cash flows, (5) consolidated statements of stockholders' equity, and (6) notes to consolidated financial statements.

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

**Describe the issuer's business so a potential investor can clearly understand the company. In answering this item, please include the following:**

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

**Business**

Paragon Technologies, Inc. ("Paragon" or the "Company"), based out of Easton, Pennsylvania, provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications through its wholly owned subsidiary, SI Systems, LLC ("SI Systems"). SI Systems' capabilities include horizontal transportation, rapid dispensing, order fulfillment, Warehouse Management Systems (WMS), Warehouse Control Systems (WCS), and aftermarket services.

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' branded products are utilized to automate the movement or selection of products and are often integrated with other automated equipment such as conveyors and robots. SI Systems is brought to market as two individual brands, SI Systems' Order Fulfillment Systems (hereafter referred to as "SI Systems OFS") and SI Systems' Production & Assembly Systems (hereafter referred to as "SI Systems PAS").

The OFS business focuses on providing order fulfillment systems to distribution operations, including DISPENSIMATIC<sup>®</sup>, Mobile-matic<sup>®</sup>, and Warehouse Management Systems and Warehouse Control Systems software solutions with our VWare<sup>™</sup> WCS product. These systems are sold primarily through a nationwide network of authorized material handling integrators.

The PAS business focuses on providing automated material handling systems to manufacturing and assembly operations and the U.S. government, LO-TOW<sup>®</sup> and CARTRAC<sup>®</sup>, horizontal transportation technologies. These systems are sold primarily to end users.

SI Systems' automated material handling systems are marketed, designed, sold, installed, and serviced by its own staff or subcontractors as labor-saving devices to improve productivity, quality, and reduce costs. SI Systems' integrated material handling solutions involve both standard and specially designed components and include integration of non-proprietary automated handling technologies to provide turnkey solutions for its customers' unique material handling needs. SI Systems' engineering staff develops and designs computer control programs required for the efficient operation of the systems and for optimizing manufacturing, assembly, and fulfillment operations.

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. The customer's 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.

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Paragon also invests in businesses and securities under its 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. 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 without Board approval, 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
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:**

**SI Systems' Branded Products**

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

**Horizontal Transport**

**LO-TOW**<sup>®</sup>. LO-TOW<sup>®</sup> is an in-floor towline conveyor. These conveyor systems are utilized in the automation of manufacturing, assembly and unit load handling in distribution environments. Industries served include the automotive, recreational and utility vehicle, distribution centers, radiation chambers, engine assembly, truck assembly, construction vehicles, newspaper facilities, farm machinery, and the U.S. government, primarily the United States Postal Service and the Defense Logistics Agency. This simple, yet reliable component design allows for a variety of configurations well suited for numerous applications. It provides reliable and efficient transportation for unit loads of all types in progressive assembly or distribution applications. Because SI Systems' LO-TOW<sup>®</sup> tow chain used with the system operates at a minimal depth, systems can be installed in existing one-story and multi-story buildings as well as newly constructed facilities. Controls sophistication varies depending upon the application. More complex systems include programmable logic controllers ("PLCs"), personal computers for data collection and operator interface, radio frequency identification and communication, bar code identification, and customer host computer communication interface. The Company believes that SI Systems is the largest supplier of in-floor towline systems in the United States. A typical LO-TOW<sup>®</sup> system requires approximately six months to engineer, manufacture, and install.

### **Order Fulfillment Systems**

#### **DISPENSIMATIC® , Mobile-matic®, VWare™**

DISPENSIMATIC® and VWare™ offer ideal solutions for reducing inefficiencies, labor-intensive methods, and long-time deliveries where high volume of small orders must be fulfilled. Industries served include pharmaceutical, entertainment, vision, nutritional supplements, health and beauty aids, cosmetics, and an assortment of various soft goods.

SI Systems' branded products include a variety of DISPENSIMATIC® models for automated order fulfillment, where volume, speed, accuracy, and efficiency are of the essence. The Pick-to-Belt, Totes Through, and Buckets Through are solutions that provide ultra-high throughput for loose-pick individual items. Additionally, the DISPENSIMATIC® allows a package to be dispensed into a tote or carton, thus achieving a high degree of accuracy and efficiency in order fulfillment.

**Mobile-matic®**, was introduced to the market in the fourth quarter of 2010 to target a wider base of potential customers. **Mobile-matic®**, a mobile version of the DISPENSIMATIC® with fewer channels, scalable, and also automatically dispenses product directly into totes being transported on an adjacent conveyor.

SI Systems' branded technologies include automated picking and replenishment solutions that complement DISPENSIMATIC®, thus offering SI Systems' customers a comprehensive solution in order fulfillment where volume of orders are processed with a high degree of accuracy. These highly sophisticated systems require customization tailored to each individual customer's requirements.

A typical DISPENSIMATIC®, VWare™, and automated order fulfillment system requires approximately six months to engineer, manufacture, and install.

#### **Aftermarket Spare Parts, Equipment and Support Service**

SI Systems provides spare and replacement parts and equipment for all of its products, along with support contract services for its order fulfillment systems.

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

Paragon Technologies, Inc.  
600 Kuebler Road  
Easton, PA 18040-9201

The Company leased 25,000 square feet in Easton, Pennsylvania for use as its principal office. The leasing agreement required fixed monthly rental payments of \$18,000. The terms of the lease also required the payment of a proportionate share of the facility’s operating expenses. The leasing agreement was secured with a \$200,000 letter of credit. The lease expired on February 20, 2013.

On November 28, 2012, the Company renewed the lease agreement to extend the term of the lease for a period of one year. Commencing on February 21, 2013, the square footage of the lease was reduced to 15,200 square feet. The renewed lease agreement requires fixed monthly rental payments of \$12,750 for one year through February 20, 2014. The terms of the lease no longer require the payment of a proportionate share of the facility’s operating expenses.

The Company believes that its Easton, Pennsylvania facility is adequate for its current operations. The Company’s operations experience fluctuations in workload due to the timing and receipt of new orders and customer job completion requirements. Currently, the Company’s facility is adequate to handle these fluctuations. In the event of an unusual demand in workload, the Company supplements its internal operations with outside subcontractors that perform services for the Company in order to complete contractual requirements for its customers. The Company 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.

**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 M. Gad .....	2010	35

Hesham M. Gad has been Chairman of the Company’s Board of Directors since March 2012. Mr. Gad is the founder and managing partner of Gad Partners Fund, a value oriented investment partnership launched in 2007, modeled after the 1950’s Buffett Partnerships and based in Athens, GA. Mr. Gad has over 13 years of investment and business management experience. Mr. Gad is also the founder of Gad Properties, LLC, a private real estate investment company focusing on the student housing market. From 2006 to 2007, while earning his MBA, Mr. Gad worked as a freelance securities analyst for UAS Asset Management, a boutique value investment firm in New York City.

Mr. Gad is also the author of the internationally published book, “The Business of Value Investing.” Mr. Gad has been extensively published on topics including investing, financial statement analysis, and security valuation on some of the most highly regarded financial websites including The Motley Fool, Investopedia, and TheStreet.com. Mr. Gad holds a B.A. in finance and an MBA in finance from the University of Georgia.

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Name, Other Positions or Offices With the Company and Principal Occupation for Past Five Years	Director Since	Age
Jack H. Jacobs.....	2012	68
<p>Jack H. Jacobs has been 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 the past six years. He has held the McDermott Chair of Politics at West Point since 2005 and has served as an NBC military analyst since 2002. Mr. 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.</p> <p>Mr. 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. From 2007 to 2012, Mr. 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; he was a director of BioNeutral Group, Inc., a public company, until 2009; and from 2009 to 2012, he was a director of Premier Exhibitions, Inc. (Nasdaq: PRXI), a public company. Mr. Jacobs is Vice Chairman of the Medal of Honor Foundation and a member of the Board of Trustees of the USO of New York. Mr. Jacobs is the author of the book "If Not Now, When?: Duty and Sacrifice in America's Time of Need." Mr. Jacobs received a Bachelor of Arts and a Master's degree from Rutgers University.</p>		
Samuel S. Weiser .....	2012	53
<p>Samuel S. Weiser is currently and since November 2011 has been President and Chief Executive Officer of Premier Exhibitions, Inc. (Nasdaq: PRXI), a provider of museum quality touring exhibitions. Mr. Weiser served as a member and Chief Operating Officer of Sellers Capital LLC, an investment management firm, from 2007 to 2010 and remains a member of the firm. From 2005 to 2007, he was a Managing Director responsible for the Hedge Fund Consulting Group within Citigroup Inc.'s Global Prime Brokerage Division. From 2002 to April 2005, he was the President and Chief Executive Officer of Foxdale Management, LLC, a consulting firm founded by Mr. Weiser that provided operational consulting to hedge funds and litigation support services in hedge fund related securities disputes. Mr. Weiser also served as Chairman of the Managed Funds Association, a lobbying organization for the hedge fund industry, from 2001 to 2003. Mr. Weiser is also a former partner in Ernst and Young. He received his B.A. in Economics from Colby College and a M.Sc. in Accounting from George Washington University.</p>		

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

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

<u>Name</u>	<u>Age</u>	<u>Office</u>
Edward Larry Strayhorn	54	President and Chief Executive Officer
Jacob Cherian	61	Vice President - Finance, Chief Financial Officer, Treasurer, and Corporate Secretary

Mr. Strayhorn has served the material handling industry for over 34 years. He has held multiple management positions at Eaton-Kenway, Inc., Mannesmann Demag and Rapistan Demag, all with a focus on automation. He was one of the principal owners of Diamond Phoenix Corp. before selling the company to Systems Logistics, and most recently served as the President of TGW Systems. Mr. Strayhorn has also served the Material Handling Industry trade organization for a number of years in various capacities, and he currently is the Executive Chairman of Material Handling Industry of America, the industry leading organization. He also serves as a board member of the Material Handling Education Foundation.

Mr. Cherian is an accounting and financial professional with over 30 years of experience in both publicly traded and privately held companies. Prior to joining the Company, Mr. Cherian held positions as Chief Financial Officer, Corporate Controller, Group Financial Controller, and various other senior accounting positions. Prior experiences include Corporate Controller of Measurement Specialties Inc. and SL Industries Inc. and Chief Financial Officer of GES Global Energy Services, Inc. and AK Stamping/Globe Manufacturing. Most recently, Mr. Cherian served as Controller and VP of Performance Management at FloDesign Wind Turbine Corp. Mr. Cherian has an MBA from Fairleigh Dickinson University in New Jersey and is a Chartered Accountant (inactive).

**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).

Except as set forth below, 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).

On June 9, 2011, Mr. Gad was charged with false statements / writings / concealment of facts in the Superior Court of Athens-Clarke County, Georgia relating to the allegation that Mr. Gad checked the incorrect box on his driver's license application completed on March 27, 2007 as to whether Mr. Gad is a U.S. citizen. On October 19, 2011, Mr. Gad pled not guilty to this charge. This case is currently pending.

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.

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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.

- 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.

#### **Security Ownership of Certain Beneficial Owners and Management**

To the best of the Company's knowledge, the following table sets forth certain information as of October 31, 2013 (unless otherwise noted) regarding the ownership of common stock (i) 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, 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)	479,880	-	28.5%
Common Stock, Par Value \$1.00 Per Share	Shaun E. Hayes (4)	234,200	-	14.0%

(1) Unless otherwise indicated, the address for each stockholder listed on the table is c/o Paragon Technologies, Inc., 600 Kuebler Road, Easton, Pennsylvania 18040.

(2) The percentage for each individual, entity or group is based on the aggregate number of shares outstanding as of September 30, 2013 (1,678,595).

(3) Mr. Gad holds 28,805 shares directly and beneficially owns 451,075 shares held by Gad Capital.

(4) Mr. Shaun E. Hayes' address is 201 Main Street, Ste 2100, Fort Worth, TX 76102.

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**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  
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:

McGladrey LLP  
751 Arbor Way, Suite 200  
Blue Bell, PA 19422  
Telephone number: (215) 641-8600  
E-mail address: [Susan.Roeder@mcgladrey.com](mailto:Susan.Roeder@mcgladrey.com)

Investor Relations Consultant:

None.

Other Advisor:

None.

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**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, Edward Larry Strayhorn, President and 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 11, 2013

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

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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, Jacob Cherian, 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 11, 2013

/s/ Jacob Cherian  
Jacob Cherian  
Chief Financial Officer

**PARAGON TECHNOLOGIES, INC.  
and Subsidiaries**

# **QUARTERLY REPORT**

**CONSOLIDATED FINANCIAL STATEMENTS — UNAUDITED  
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2013**

## CONSOLIDATED FINANCIAL STATEMENTS — UNAUDITED

### I N D E X

- **Consolidated Financial Statements:**

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**PARAGON TECHNOLOGIES, INC.**  
Consolidated Balance Sheets (Unaudited)  
September 30, 2013 and December 31, 2012  
(In Thousands, Except Share and Per Share Data)

	September 30, 2013	December 31, 2012
<b><u>Assets</u></b>		
Current assets:		
Cash and cash equivalents .....	\$ 2,052	\$ 4,504
Receivables:		
Trade accounts .....	1,731	1,754
Other receivables .....	11	10
Total receivables .....	<u>1,742</u>	<u>1,764</u>
Costs and estimated earnings in excess of billings .....	<u>19</u>	<u>18</u>
Inventories:		
Raw materials .....	73	154
Work-in-process .....	74	44
Finished goods .....	169	397
Total inventories .....	<u>316</u>	<u>595</u>
Prepaid expenses and other current assets .....	<u>146</u>	<u>45</u>
Total current assets .....	<u>4,275</u>	<u>6,926</u>
Marketable securities .....	<u>3,237</u>	<u>1,268</u>
Machinery and equipment, at cost:		
Machinery and equipment .....	1,184	1,177
Software development in process .....	131	-
Less: accumulated depreciation .....	<u>1,123</u>	<u>1,099</u>
Net machinery and equipment .....	<u>192</u>	<u>78</u>
Goodwill/acquisition cost .....	<u>319</u>	<u>-</u>
Total assets .....	<u>\$ 8,023</u>	<u>\$ 8,272</u>

*See accompanying notes to consolidated financial statements.*

*(Continued)*

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

September 30, 2013 and December 31, 2012

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

	September 30, 2013	December 31, 2012
<b><u>Liabilities and Stockholders' Equity</u></b>		
Current liabilities:		
Accounts payable.....	\$ 1,015	\$ 879
Billings in excess of costs and estimated earnings.....	452	1,419
Accrued salaries, wages, and commissions .....	324	95
Accrued product warranties .....	121	132
Unearned support contract revenue .....	250	349
Accrued other liabilities .....	224	187
Total current liabilities.....	<u>2,386</u>	<u>3,061</u>
Commitments and contingencies (See Notes 6 and 7)		
Stockholders' equity:		
Common stock, \$1 par value; authorized 20,000,000 shares; issued and outstanding 1,678,595 shares as of September 30, 2013 and 1,656,854 as of December 31, 2012 .....	1,679	1,657
Additional paid-in capital .....	3,486	3,441
Unamortized restricted stock .....	-	5
Retained earnings (deficit) .....	617	(15)
Accumulated other comprehensive income/(loss) .....	(145)	123
Total stockholders' equity.....	<u>5,637</u>	<u>5,211</u>
Total liabilities and stockholders' equity.....	<u>\$ 8,023</u>	<u>\$ 8,272</u>

*See accompanying notes to consolidated financial statements.*

**PARAGON TECHNOLOGIES, INC.**

Consolidated Statements of Operations (Unaudited)

For the Three and Nine Months Ended September 30, 2013 and 2012

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

	Three Months Ended		Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Net sales.....	\$ 3,302	\$ 2,203	\$ 9,782	\$ 6,646
Cost of sales.....	2,461	1,708	7,024	5,118
Gross profit on sales.....	<u>841</u>	<u>495</u>	<u>2,758</u>	<u>1,528</u>
Operating expenses:				
Selling, general and administrative expenses.....	677	526	1,925	1,712
Product development costs.....	<u>15</u>	<u>5</u>	<u>30</u>	<u>61</u>
Total operating expenses.....	<u>692</u>	<u>531</u>	<u>1,955</u>	<u>1,773</u>
Operating income (loss) ....	<u>149</u>	<u>(36)</u>	<u>801</u>	<u>(245)</u>
Other income (expense):				
Interest income.....	25	4	46	17
Interest expense.....	(1)	-	(1)	-
Other expense, net.....	<u>(82)</u>	<u>2</u>	<u>(112)</u>	<u>(4)</u>
Total other income (expense), net.....	<u>(58)</u>	<u>6</u>	<u>(67)</u>	<u>13</u>
Income (loss) before income taxes .....	91	(30)	734	(232)
Income tax expense .....	<u>(15)</u>	<u>1</u>	<u>102</u>	<u>3</u>
Net income (loss).....	<u>\$ 106</u>	<u>\$ (31)</u>	<u>\$ 632</u>	<u>\$ (235)</u>
Basic earnings (loss) per share .....	<u>\$ 0.07</u>	<u>\$ (0.02)</u>	<u>\$ 0.40</u>	<u>\$ (0.15)</u>
Diluted earnings (loss) per share .....	<u>\$ 0.06</u>		<u>\$ 0.35</u>	
Weighted average shares outstanding.....	1,598,659	1,578,446	1,598,659	1,563,964
Dilutive effect of stock options.....	<u>189,000</u>	<u>-</u>	<u>189,000</u>	<u>-</u>
Weighted average shares outstanding assuming dilution .....	<u>1,787,659</u>	<u>1,578,446</u>	<u>1,787,659</u>	<u>1,563,964</u>

See accompanying notes to consolidated financial statements.

**PARAGON TECHNOLOGIES, INC.**

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

For the Three and Nine Months Ended September 30, 2013 and 2012

*(In Thousands)*

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u> <u>2013</u>	<u>September 30,</u> <u>2012</u>	<u>September 30,</u> <u>2013</u>	<u>September 30,</u> <u>2012</u>
Net income (loss) .....	\$ 106	(31)	\$ 632	\$ (235)
Other comprehensive income:				
Unrealized gain/(loss) on marketable securities .....	<u>(23)</u>	<u>6</u>	<u>(268)</u>	<u>6</u>
Comprehensive income (loss) .....	\$ <u>83</u>	<u>(25)</u>	\$ <u>364</u>	<u>(229)</u>

*See accompanying notes to consolidated financial statements.*

**PARAGON TECHNOLOGIES, INC.**

Consolidated Statements of Stockholders' Equity (Unaudited)  
 For the Nine Months Ended September 30, 2013 and December 31, 2012  
 (In Thousands, Except Share Data)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Unamortized Restricted Stock	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Amount					
Balance at December 31, 2010.....	1,554,310	\$ 1,554	\$ 3,281	\$ 48	\$ -	\$ -	\$ 4,883
Net income .....	-	-	-	191	-	-	191
Balance at December 31, 2011.....	1,554,310	1,554	3,281	239	-	-	5,074
Net loss .....	-	-	-	(254)	-	-	(254)
Net change in unrealized gain on marketable securities, net of tax .....	-	-	-	-	-	123	123
Issue of common stock in lieu of directors' fees under directors' stock plan.....	21,544	22	33	-	-	-	55
Restricted stock grant to employee.....	-	-	-	-	5	-	5
Stock option grants to officers.....	-	-	5	-	-	-	5
Sale of common stock for cash .....	81,000	81	122	-	-	-	203
Balance at December 31, 2012.....	1,656,854	1,657	3,441	(15)	5	123	5,211
Net income .....	-	-	-	632	-	-	632
Net change in unrealized gain on marketable securities, net of tax .....	-	-	-	-	-	(268)	(268)
Issue of common stock in lieu of directors' fees under directors' stock plan.....	18,741	19	38	-	-	-	57
Restricted stock grant to employee.....	-	-	-	-	2	-	2
Issue of stock grant to employee .....	3,000	3	4	-	(7)	-	-
Stock option grants to officers.....	-	-	3	-	-	-	3
Balance at September 30, 2013.....	1,678,595	\$ 1,679	\$ 3,486	\$ 617	\$ -	\$ (145)	\$ 5,637

See accompanying notes to consolidated financial statements.

**PARAGON TECHNOLOGIES, INC.**

Consolidated Statements of Cash Flows (Unaudited)  
 For the Nine Months Ended September 30, 2013 and 2012  
 (In Thousands)

	Nine Months Ended	
	September 30, 2013	September 30, 2012
Cash flows from operating activities:		
Net income (loss).....	\$ 632	\$ (235)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation of machinery and equipment .....	25	36
Realized gains on investments .....	34	-
Issue of common stock in lieu of directors' fees .....	-	30
Stock-based compensation.....	67	-
Deferred taxes.....	18	-
Change in operating assets and liabilities:		
Receivables.....	22	(29)
Costs and estimated earnings in excess of billings.....	(1)	(168)
Inventories .....	279	(59)
Prepaid expenses and other current assets.....	(101)	2
Accounts payable .....	136	632
Billings in excess of costs and estimated earnings.....	(967)	222
Accrued salaries, wages, and commissions .....	229	(71)
Accrued product warranties.....	(11)	32
Unearned support contract revenue.....	(99)	(122)
Accrued other liabilities and other adjustments.....	23	(43)
Net cash provided by (used in) operating activities.....	<u>286</u>	<u>227</u>
Cash flows from investing activities:		
Purchases of investments .....	(2,757)	(212)
Proceeds from the disposition of machinery and equipment .....	-	1
Purchases of machinery and equipment.....	(1)	(15)
Expenditures for capitalized software in process .....	(131)	-
Proceeds from sale of investments .....	470	-
Acquisition costs.....	(319)	-
Net cash used in investing activities.....	<u>(2,738)</u>	<u>(226)</u>
Cash flows from financing activities:		
Sale of common stock .....	-	203
Net cash provided by (used in) financing activities .....	<u>-</u>	<u>203</u>
Increase in cash and cash equivalents .....	(2,452)	204
Cash and cash equivalents, beginning of year .....	4,504	4,871
Cash and cash equivalents, end of period .....	<u>\$ 2,052</u>	<u>\$ 5,075</u>
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest expense.....	<u>\$ 1</u>	<u>\$ -</u>
Income taxes .....	<u>\$ 18</u>	<u>\$ 25</u>
Supplemental disclosures of noncash investing activities:		
Mark to market on available for sale securities, gross .....	<u>\$ (352)</u>	<u>\$ -</u>

See accompanying notes to consolidated financial statements.

## **PARAGON TECHNOLOGIES, INC.**

Notes To Consolidated Financial Statements (Unaudited)

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

#### **Description of Business and Concentration of Credit Risk**

Paragon Technologies, Inc. ("Paragon" or the "Company"), based out of Easton, Pennsylvania, provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications through its wholly owned subsidiary, SI Systems, LLC ("SI Systems"). SI Systems' capabilities include horizontal transportation, rapid dispensing, order fulfillment, Warehouse Management Systems (WMS), Warehouse Control Systems (WCS), and aftermarket services.

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' branded products are utilized to automate the movement or selection of products and are often integrated with other automated equipment such as conveyors and robots. SI Systems is brought to market as two individual brands, SI Systems' Order Fulfillment Systems (hereafter referred to as "SI Systems OFS") and SI Systems' Production & Assembly Systems (hereafter referred to as "SI Systems PAS").

The OFS business focuses on providing order fulfillment systems to distribution operations, including DISPENSIMATIC®, Mobile-matic®, and Warehouse Management Systems and Warehouse Control Systems software solutions with our VWare™ WCS product. These systems are sold primarily through a nationwide network of authorized material handling integrators.

The PAS business focuses on providing automated material handling systems to manufacturing and assembly operations and the U.S. government, LO-TOW®, and CARTRAC®, horizontal transportation technologies. These systems are sold primarily to end users.

For the three months ended September 30, 2013, three customers individually accounted for sales of 63.2%, 23.8%, and 4.5%. For the three months ended September 30, 2012, three customers individually accounted for sales of 21.9%, 13.1%, and 11.6%. No other customers accounted for over 10% of sales.

For the three months ended September 30, 2013, three customers individually owed the Company 44.8%, 12.1%, and 9.9% in trade receivables. All of these customers were included in the 2013 sales concentration noted above. For the three months ended September 30, 2012, four customers individually owed the Company 26.6%, 20.9%, 12.6%, and 10.6% in trade receivables. Two of these customers were included in the 2012 sales concentration noted above. No other customers owed SI Systems in excess of 10% of trade receivables at September 30, 2013 and 2012. The Company believes that the concentration of credit risk in its trade receivables is substantially mitigated by SI Systems' ongoing credit evaluation process as well as the general creditworthiness of its customer base.

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. The 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 SI Systems 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 maintains its cash and cash equivalents in financial institutions located in the United States of America. At times, cash balances may be in excess of F.D.I.C. limits. The Company's 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 SI Systems, Inc., a wholly owned subsidiary, after elimination of intercompany balances and transactions.

**PARAGON TECHNOLOGIES, INC.**

Notes To Consolidated Financial Statements (Unaudited) (Continued)

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

**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, and revenue recognition on fixed price contracts.

**Innovative Automation, Inc.**

On April 18, 2013 we acquired Innovative Automation, Inc. (IA). We purchased all the outstanding capital stock with cash on hand. IA designs, builds and supports warehouse control systems software and has been in business since 1993.

The results of operations for IA have been included in the accompanying consolidated financial statements from the acquisition date forward. Revenue and costs since April 18, 2013 are not significant and therefore not reported separately. The purchase price for the acquisition consists of two parts. Part one consists of a cash payment of \$562,500 and part two consists of additional provisional payments of \$1,857,800, primarily based on sales and gross margin generated from future revenue through the year 2020. The provisional payments are based on expected revenue and gross margin, all of which are extremely variable.

Fair value of cash payments (payable in installments) .....	\$	\$504,000
Future consideration on earn-out linked to bookings (provisional) .....		\$767,000
Future consideration for additional earn-out linked to gross margin (provisional) .....		\$573,000

The provisional allocation of the purchase price to the assets acquired and liabilities assumed is based upon the estimated fair values at the date of acquisition. The fair values of the assets and liabilities included in the table below are preliminary/provisional and subject to change principally as we are currently in the process of obtaining independent valuations of assets acquired and liabilities assumed.

The excess of the purchase price over the net tangible and identifiable intangible assets is reflected as goodwill. The following table summarizes the preliminary estimates of fair value of the assets acquired and the liabilities assumed as of the acquisition date:

<b><u>Assets</u></b>	
Bank balance .....	\$ 99
Accounts receivable .....	114,054
Other assets .....	1,841
Goodwill (provisional) .....	2,304,306
<b><u>Liabilities</u></b>	
Unsecured loan .....	40,850
Accounts payable .....	34,536
Deferred revenue .....	64,711
Cash and provisional payments .....	2,420,300

The fair value for acquired assets is being determined by an independent valuation expert. We incurred \$36,583 of acquisition costs related to IA.

## **PARAGON TECHNOLOGIES, INC.**

Notes To Consolidated Financial Statements (Unaudited) *(Continued)*

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

#### **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, and other highly liquid investments purchased with an original maturity of three months or less.

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

Accounts receivable are stated at outstanding balances, less an allowance for doubtful accounts. The Company provides an allowance for doubtful accounts determined by a specific identification of individual accounts. The Company writes off receivables upon determination that no further collections are probable. There was no allowance for doubtful accounts as of September 30, 2013 and 2012.

#### **Inventories**

Inventories are valued at the lower of average cost or market. Inventories primarily consist of materials purchased or manufactured for stock.

#### **Marketable Securities**

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

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

**PARAGON TECHNOLOGIES, INC.**

Notes To Consolidated Financial Statements (Unaudited) (Continued)

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

**Marketable Securities (Continued)**

The Company has not recognized any other-than-temporary impairment losses for the nine months ended September 30, 2013.

The amortized cost and approximate fair value of marketable securities available-for-sale as of September 30, 2013 are summarized as follows (in thousands):

	As of September 30, 2013			Fair Value
	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	
Equity Securities .....	\$3,381	\$27	\$171	\$3,237

At September 30, 2013, the Company had two equity securities in an unrealized loss position for less than 12 months. The decline in fair value is not due to credit losses. The Company does not intend to sell these securities prior to recovery and it is more likely than not that the Company will not be required to sell these securities prior to recovery and, therefore, no securities are deemed to be other-than-temporarily impaired. Fair value accounting guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions. In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

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

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

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

**PARAGON TECHNOLOGIES, INC.**Notes To Consolidated Financial Statements (Unaudited) *(Continued)***(1) Description of Business and Summary of Significant Accounting Policies** *(Continued)***Marketable Securities** *(Continued)*

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at September 30, 2013 are as follows *(in thousands)*:

	As of September 30, 2013			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity Securities.....	\$3,237	\$3,237	\$ -	\$ -

**Machinery and Equipment**

Machinery and equipment are recorded at cost and are depreciated on the straight-line method over the estimated useful lives of individual assets. The ranges of lives used in determining depreciation rates for machinery and equipment is generally 3 - 7 years. 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.

**Asset Impairment**

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.

**Revenue and Cost Recognition**

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

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

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

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

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

## PARAGON TECHNOLOGIES, INC.

Notes To Consolidated Financial Statements (Unaudited) (Continued)

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

#### Unearned Support Contract Revenue

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

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

#### Product Development Costs

The Company expenses product development costs as incurred.

#### Accrued Product Warranty

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

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

	Beginning Balance January 1	Additions (Reductions) Included in Cost of Sales	Claims	Ending Balance September 30
2013.....	\$ 132	\$ 59	\$ (70)	\$ 121
2012.....	\$ 76	\$ 37	\$ (5)	\$ 108

#### Income Taxes

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

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

#### Stock-Based Compensation

The Company has a shared-based compensation plan in place and records the associated stock-based compensation expense over the requisite service period. These share-based compensation plans and related compensation expense are discussed more fully in Note 3 to the consolidated financial statements.

## **PARAGON TECHNOLOGIES, INC.**

Notes To Consolidated Financial Statements (Unaudited) *(Continued)*

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

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

Restricted stock awards that are service-based are recorded as deferred compensation and amortized into compensation expense on a straight-line basis over the vesting period, which ranges from three to four years in duration. Compensation cost for service-based restricted stock is based on the grant date fair value of the award, which is the closing market price of the Company's common stock on the grant date multiplied by the number of shares awarded.

#### **Earnings Per Share**

Basic and diluted earnings per share for the three months ended September 30, 2013 and 2012 are based on the weighted average number of shares outstanding. In addition, diluted earnings per share reflect the effect of dilutive securities which include the shares that would be outstanding assuming the exercise of dilutive stock incentive plan awards. The number of shares that would be issued from the exercise has been reduced by the number of shares that could have been purchased from the proceeds at the average market price of the Company's common stock.

### **(2) Line of Credit**

On February 19, 2009, the Company established a \$5,000,000 line of credit facility with its principal bank to be used primarily for working capital purposes. The line of credit facility contained various non-financial covenants and is secured by all of the Company's accounts receivables and inventory. The availability on the line of credit was \$3,300,000 as of December 31, 2012. Interest on the line of credit facility was at the LIBOR Market Index Rate plus 1.25%. The leasing agreement associated with the Company's principal office is secured with a \$200,000 letter of credit at December 31, 2012 under the line of credit facility. There were no borrowings outstanding, and the line of credit expired on November 30, 2012. The Company's outstanding Letter of Credit expired in February 2013.

On May 30, 2013, the Company established a \$750,000 line of credit facility with its principal bank to be used primarily for working capital purposes. The line of credit facility contained various non-financial covenants and is secured by all of the Company's accounts receivables and inventory. The availability on the line of credit was \$750,000 as of September 30, 2013. Interest on the line of credit facility is based on the "Wall Street Journal Prime." There were no borrowings outstanding as of September 30, 2013.

### **(3) Stock Options and Nonvested 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.

Under the Plan, officers have been granted options to purchase shares of common stock at the market price at the date of grant. Stock options vest in four or five equal annual installments beginning on the first anniversary of the date of grant. Vested stock option awards may be exercised through payment of cash, exchange of mature shares, or through a broker. As of September 30, 2013, 189,000 stock options are outstanding under the Plan, and all stock options have a term of ten years and expire in August 2022. The exercise price of the stock options outstanding under the Plan are \$2.51, \$2.48 and \$2.59.

**PARAGON TECHNOLOGIES, INC.**Notes To Consolidated Financial Statements (Unaudited) *(Continued)***(3) Stock Options and Nonvested Stock** *(Continued)***2012 Equity Incentive Plan** *(Continued)*

Stock-based compensation expense recognized during the nine months ended September 30, 2013 for stock-based compensation programs was \$66,623. Stock-based compensation expense recognized during the nine months ended September 30, 2012 consisted of expensing \$44,370 for employee stock options, and \$5,000 for nonvested stock. All of the stock-based compensation expense recognized was a component of selling, general and administrative expenses.

**Stock Options**

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.

The weighted-average key assumptions used in determining the fair value of options granted for the three months ended September 30, 2013, are as follows:

	Three Months Ended September 30, 2013
Weighted-average volatility .....	25.45%
Weighted-average risk-free interest rate .....	0.62%
Weighted-average expected term in years.....	4.1
Dividend yield .....	0.00%
Weighted-average grant date fair value per share .....	0.49

Historical information is the primary basis for the selection of the expected volatility of options granted. The risk-free interest rate is selected based upon yields of United States Treasury issues with a term equal to the expected life of the option being valued. The expected term of options granted is derived from the output of a lattice option valuation model and represents the period of time that options granted are expected to be outstanding. The Company uses historical data to estimate option exercise behavior and employee termination with the valuation model.

A summary of stock option activity is presented below:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2013.....	149,000	\$ 2.50	4.4	\$ -
Granted .....	40,000	2.59	4.0	-
Exercised.....	-	-	-	-
Forfeited .....	-	-	-	-
Outstanding at September 30, 2013.....	<u>189,000</u>	<u>\$ 2.52</u>	<u>4.4</u>	<u>\$ -</u>
Exercisable at September 30, 2013.....	<u>-</u>	<u>\$ -</u>	<u>-</u>	<u>\$ -</u>

**Directors' Fees**

Directors are entitled to the following director compensation (January 2013 to June 2013):

- Annual retainer of \$20,000 per year, paid quarterly, with the first two quarters paid in cash and the last two quarters paid in equity, per the Director's Equity Plan;
- Fee of \$2,500 per director for each in-person Board Meeting;
- The Company will pay hotel lodging for in-person Board Meetings;
- Fee of \$500 per director for each Board Teleconference Meeting;
- Fee of \$1,000 for the Chair of the Audit Committee for each committee meeting;

## PARAGON TECHNOLOGIES, INC.

Notes To Consolidated Financial Statements (Unaudited) *(Continued)*

### **(3) Stock Options and Nonvested Stock** *(Continued)*

#### **Directors' Fees** *(Continued)*

- Fee of \$500 per director for each committee meeting;
- Directors are entitled to the following director compensation (July 2013 to December 2013):
  - Annual retainer of \$40,000 per year:
    - \$30,000 in cash payable quarterly; and
    - \$10,000 in shares of common stock under the Equity Incentive Plan.
- For year ended December 31, 2012, the Company issued 7,544 shares to the directors under this Plan, with an expense of \$20,000; and
- For the nine months ended September 30, 2013, there were 3,936 shares issued to the directors under this Plan, with an expense of \$10,000.

On July 22, 2013, the Board modified the director compensation program for each of the directors other than Mr. Gad. Under the modified program, each director will receive an annual retainer of \$40,000, with \$30,000 payable in cash and \$10,000 payable in shares of common stock of the Company under the 2012 Equity Incentive Plan. The cash component of the new compensation program was effective as of July 1, 2013, and the equity component will be effective as of January 1, 2014. The new director compensation program replaces the prior program, including all retainers and meeting fees, but the directors will continue to be reimbursed for their travel and lodging costs incurred in connection with attendance at all in-person meetings of the Board. Mr. Gad's compensation was not modified in connection with the new director compensation program.

#### **Chairman's Compensation**

In recognition of Mr. Gad's efforts and responsibilities to the Company in his role as Chairman including directing the Company's capital allocation program, on September 14, 2012, the independent directors of the Board established Mr. Gad's annual compensation as follows:

- Annual retainer of \$110,000 per year, \$50,000 in cash and \$60,000 in stock, paid quarterly, with the common stock being valued based on the average of the closing bid and asked prices for the Company's common stock on the OTC Markets for the 30 trading days immediately preceding stock issuance. This was revised in June 2013 as follows:
  - Annual retainer of \$110,000 per year, payable:
    - \$80,000 in cash; and
    - \$30,000 in shares of common stock under the 2012 Equity Incentive Plan.
- This compensation will be paid to Mr. Gad in lieu of all other Board compensation and meeting fees. The compensation was determined by the Company's independent directors, in consultation with the Company's outside counsel, and will be reviewed annually;
- For the year ended December 31, 2012, the Company issued 14,000 shares to the Chairman under this Plan, with an expense of \$35,000; and
- For the nine months ended September 30, 2013, the Company issued 14,805 shares to the Chairman under this Plan, with an expense of \$37,500.

#### **Employee Equity Grants**

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

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

## **PARAGON TECHNOLOGIES, INC.**

Notes To Consolidated Financial Statements (Unaudited) *(Continued)*

### **(3) Stock Options and Nonvested Stock** *(Continued)*

#### **Employee Equity Grants** *(Continued)*

Each of these options has an exercise price equal to the average of the closing bid and asked prices for the Company's common stock on the OTC Markets for the thirty trading days immediately preceding the grant date. The term of each of these options is ten years from the date of grant. In the event of a change in control of the Company, the vesting of each of these options will be accelerated. The Company issued 3,000 shares of the Company's common stock under the Plan to another recently hired employee of the Company on February 1, 2013.

On April 22, 2013, in connection with the commencement of his employment as the Vice-President Software and Technology, Mr. Kevin Tedford was granted an option to purchase 40,000 shares of the Company's common stock. The option will vest, subject to Mr. Tedford's continued employment with the Company through the applicable vesting date, over a period of four years commencing on April 22, 2014.

### **(4) Employee Benefit Plans**

The Company has a defined contribution Retirement Savings Plan for its 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 have been suspended for an indefinite period of time as part of a cost-reduction initiative. The Plan also contains provisions for profit sharing contributions in the form of cash as determined annually by the Company's Board of Directors; however, there were no profit sharing contributions for the nine months ended September 30, 2013 and 2012. Total expense for the Retirement Savings Plan, including Plan expenses, was \$500 for the nine months ended September 30, 2013. There was no expense for the three months ended September 30, 2012.

### **(5) Income Taxes**

The Company has federal net operating losses of approximately \$1,130,000 at December 31, 2012, expiring at various times through December 31, 2032. The Company has state net operating losses of approximately \$110,000 at December 31, 2012, expiring at various times based on individual state limits.

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. For the three months ended September 30, 2013 and 2012, there was no expense related to interest and penalties, net of federal benefit recognized in the statements of operations.

The Company 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 2009.

### **(6) Contingencies**

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

### **(7) Commitments**

The Company leased 25,000 square feet in Easton, Pennsylvania for use as its principal office. The leasing agreement required fixed monthly rental payments of \$18,000. The terms of the lease also required the payment of a proportionate share of the facility's operating expenses. The leasing agreement was secured with a \$200,000 letter of credit. The lease expired on February 20, 2013.

**PARAGON TECHNOLOGIES, INC.**

Notes To Consolidated Financial Statements (Unaudited) (Continued)

**(7) Commitments** (Continued)

On November 28, 2012, the Company renewed the lease agreement to extend the term of the lease for a period of one year. Commencing on February 21, 2013, the square footage of the lease was reduced to 15,200 square feet. The renewed lease agreement requires fixed monthly rental payments of \$12,750 for one year through February 20, 2014. The terms of the lease no longer require the payment of a proportionate share of the facility's operating expenses.

Total rental expense for the nine months ending September 30, 2013 and 2012 approximated \$150,750, and \$172,100, respectively.

Future minimum rental commitments at September 30, 2013 are as follows (in thousands):

	<u>Operating Leases</u>
2013.....	\$ 38
2014.....	25
Total .....	<u>\$ 63</u>

**(8) Stock Repurchase Program**

On August 12, 2004, the Company's Board of Directors approved a program to repurchase up to \$1,000,000 of its outstanding common stock. The Company's Board of Directors amended its existing stock repurchase program on several occasions during 2005, 2006, 2007, and 2008 by increasing the amount it has authorized management to repurchase from up to \$1,000,000 of the Company's common stock to up to \$22,000,000.

There were no stock repurchases during the three months ended September 30, 2013 and 2012.

From the inception of the Company's stock repurchase program on August 12, 2004 through December 31, 2012, the Company repurchased 2,850,100 shares of common stock at a weighted average cost, including brokerage commissions, of \$6.75 per share. Cash expenditures for the stock repurchases since the inception of the program were \$19,239,194. As of May 10, 2013, \$2,760,806 remained available for repurchases under the stock repurchase program.

On May 10, 2013, the Company's Board of Directors approved cancellation of the stock repurchase program started in 2004.

**(9) Subsequent Events**

The Company is not aware of any subsequent events that would require recognition or disclosure in the consolidated financial statements.

On October 17, 2013, SED International Holdings, Inc. ("SED"), its then-existing directors and the Company and four of its candidates for election to the SED Board of Directors entered into an Agreement of Compromise, Settlement and Release (the "Settlement Agreement") to transition leadership of SED's Board of Directors. Under the terms of the Settlement Agreement, each of the then-existing directors of SED resigned, and the Company's four board candidates were appointed to SED's Board of Directors. As of November 5, 2013, two of the Company's directors, Mr. Hesham M. Gad and Mr. Samuel S. Weiser, serve on SED's Board of Directors with two other directors. The Settlement Agreement included mutual releases between SED and the Company, the other parties to the agreement and certain of their affiliates.

**PARAGON TECHNOLOGIES, INC.**

Notes To Consolidated Financial Statements (Unaudited) *(Continued)*

**(10) Recently Issued Accounting Pronouncements**

ASU 2013-02 “Comprehensive Income (Topic 220) - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.” ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. Substantially all of the information that this Update requires already is required to be disclosed elsewhere in the financial statements under U.S. GAAP. However, the new requirement about presenting information about amounts reclassified out of accumulated other comprehensive income and their corresponding effect on net income will present, in one place, information about significant amounts reclassified and, in some cases, cross-references to related footnote disclosures. Prior to implementation of ASU 2013-02, this information was presented in different places throughout the financial statements. ASU 2013-02 is effective for reporting periods beginning after December 15, 2012 and is not expected to have a significant impact on the Company's consolidated financial position, results of operations, or cash flows.

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