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PARAGON TECHNOLOGIES INC
Form 10-Q
November 14, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For The Quarterly Period Ended September 30, 2001

Commission File No. 1-15729

PARAGON TECHNOLOGIES, INC.

(Exact Name Of Registrant As Specified In Its Charter)

Pennsylvania

22-1643428

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification No.)

600 Kuebler Road, Easton, PA

18040

(Address of Principal Executive Offices)

(Zip Code)

Registrant's Telephone Number, Including Area Code:

610-252-3205

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

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Number of shares of common stock, par value \$1.00 per share, outstanding as of October 31, 2001: 4,221,635.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Paragon Technologies, Inc. and Subsidiary
 Consolidated Balance Sheets
 September 30, 2001 and December 31, 2000
 (In Thousands, Except Share Data)

	(UNAUDITED) September 30, 2001	December 31, 2000
	-----	-----
Assets		

Current assets:		
Cash and cash equivalents, principally time deposits	\$ 3,761	7,925
Receivables:		
Trade (net of allowance for doubtful accounts of \$98 as of September 30, 2001 and \$54 as of December 31, 2000)	8,838	7,040
Notes and other receivables	1,144	301
Total receivables	----- 9,982	----- 7,341
Costs and estimated earnings in excess of billings	1,223	1,665
Inventories:		
Raw materials	1,957	2,198
Work-in-process	363	340
Finished goods	527	508
Total inventories	----- 2,847	----- 3,046
Deferred income tax benefits	2,326	2,326
Prepaid expenses and other current assets	474	547
Total current assets	----- 20,613	----- 22,850
	-----	-----

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Property, plant and equipment, at cost:		
Land	27	27
Buildings and improvements	3,746	3,746
Machinery and equipment	6,871	6,341
	-----	-----
	10,644	10,114
Less: accumulated depreciation	(7,881)	(7,334)
	-----	-----
Net property, plant and equipment	2,763	2,780
	-----	-----
Investments in joint ventures	2,373	2,000
Excess of cost over fair value of net assets acquired, less amortization of \$935 as of September 30, 2001 and \$585 as of December 31, 2000	17,775	18,125
Other assets, at cost less accumulated amortization of \$84 as of September 30, 2001 and \$210 as of December 31, 2000	128	162
	-----	-----
Total assets	\$ 43,652	45,917
	=====	=====

See accompanying notes to consolidated financial statements.

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Consolidated Balance Sheets
September 30, 2001 and December 31, 2000
(In Thousands, Except Share Data)

	(UNAUDITED) September 30, 2001	December 31 2000
	-----	-----
Liabilities and Stockholders' Equity		

Current liabilities:		
Current installments of long-term debt	\$ 2,302	1,521
Accounts payable	4,344	4,412
Customers' deposits and billings in excess of costs and estimated earnings for completed and uncompleted contracts	4,113	4,446
Accrued salaries, wages, and commissions	856	2,130
Income taxes payable	-	369
Accrued royalties payable	87	253
Accrued product warranties	755	857
Accrued pension and retirement		

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savings plan liabilities	1,169	688
Accrued restructuring expenses	709	-
Accrued other liabilities	914	517
	-----	-----
Total current liabilities	15,249	15,193
	-----	-----
Long-term liabilities:		
Long-term debt, excluding current installments:		
Term loan	7,475	9,775
Subordinated notes payable	3,000	3,000
Other	480	5
	-----	-----
Total long-term debt	10,955	12,780
Deferred income taxes payable	637	823
Deferred compensation	105	141
	-----	-----
Total long-term liabilities	11,697	13,744
	-----	-----
Stockholders' equity:		
Common stock, \$1 par value; authorized 20,000,000 shares; issued and outstanding 4,221,635 shares as of September 30, 2001 and 4,194,869 shares as of December 31, 2000	4,222	4,195
Additional paid-in capital	7,071	6,882
Retained earnings	5,691	5,903
Accumulated other comprehensive loss	(278)	-
	-----	-----
Total stockholders' equity	16,706	16,980
	-----	-----
Total liabilities and stockholders' equity	\$ 43,652	45,917
	=====	=====

See accompanying notes to consolidated financial statements.

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Item 1. Financial Statements (Continued)

 Paragon Technologies, Inc. and Subsidiary
 Consolidated Statements of Operations (Unaudited)
 For the Three and Nine Months Ended September 30, 2001 and September 30, 2000
 (In Thousands, Except Share And Per Share Data)

Three Months Ended		Nine Months Ended	
September 30, 2001	September 30, 2000	September 30, 2001	September 30, 2000
-----	-----	-----	-----

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Net sales	\$	12,796	13,473	38,947	48,506
Cost of sales		9,499	9,286	28,994	35,371
Gross profit on sales		3,297	4,187	9,953	13,135
Selling, general and administrative expenses		2,213	2,506	7,899	7,764
Product development costs		86	28	402	137
Amortization of goodwill		117	119	351	352
Restructuring expenses		-	-	1,538	337
Interest expense		310	400	1,001	1,237
Interest income		(35)	(126)	(215)	(262)
Equity in income of joint ventures		(148)	(45)	(373)	(116)
Other income, net		(81)	(81)	(283)	(290)
		2,462	2,801	10,320	9,159
Earnings (loss) before income taxes		835	1,386	(367)	3,976
Income tax expense (benefit)		366	538	(155)	1,571
Net earnings (loss)	\$	469	848	(212)	2,405
Basic earnings (loss) per share	\$.11	.20	(.05)	.57
Diluted earnings (loss) per share	\$.11	.20	(.05)	.56
Weighted average shares outstanding		4,214,191	4,194,869	4,207,575	4,188,208
Dilutive effect of stock options		26,375	1,649	33,474	1,626
Dilutive effect of phantom stock units		15,617	14,673	17,381	15,587
Weighted average shares outstanding assuming dilution		4,256,183	4,211,191	4,258,430	4,205,421

See accompanying notes to consolidated financial statements.

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Item 1. Financial Statements (Continued)

 Paragon Technologies, Inc. and Subsidiary
 Consolidated Statements of Comprehensive Income (Unaudited)
 For the Three and Nine Months Ended September 30, 2001 and September 30, 2000
 (In Thousands)

	Three Months Ended		Nine Months Ended	
	September 30, 2001	September 30, 2000	September 30, 2001	September 30, 2000
Net earnings (loss)	\$ 469	848	(212)	2,405
Other comprehensive income (loss), net of tax:				
Cash flow hedge:				
Cumulative effect of adoption of FAS 133	-	-	(96)	-
Change in fair value during the period	(132)	-	(182)	-
Total other comprehensive income (loss)	(132)	-	(278)	-
Comprehensive income (loss)	\$ 337	848	(490)	2,405

See accompanying notes to consolidated financial statements.

Item 1. Financial Statements (Continued)

 Paragon Technologies, Inc. and Subsidiary
 Consolidated Statements of Cash Flows (Unaudited)
 For the Nine Months Ended September 30, 2001 and September 30, 2000
 (In Thousands, Except Share Data)

	Nine Months Ended	
	September 30, 2001	September 30, 2000

Cash flows from operating activities:		
Net earnings (loss)	\$ (212)	2,405
Adjustments to reconcile net earnings (loss) to net cash provided (used) by operating activities:		
Depreciation of plant and equipment	547	452
Amortization of intangibles	383	401
Gain on disposition of equipment	-	(2)
Equity in income of joint ventures	(373)	(116)
Issuance of 9,926 and 9,991 common shares, respectively, as noncash interest payment on subordinated notes	75	75
Issuance of 12,390 common shares as payment of employee's bonus	111	-
Change in operating assets and liabilities:		
Receivables	(2,641)	121
Costs and estimated earnings in excess of billings	442	704
Inventories	199	230
Prepaid expenses and other current assets	73	197
Other noncurrent assets	1	2
Accounts payable	(68)	(398)
Customers' deposits and billings in excess of costs and estimated earnings for completed and uncompleted contracts	(333)	(791)
Accrued salaries, wages, and commissions	(1,274)	238
Income taxes payable	(369)	930
Accrued royalties payable	(166)	(61)
Accrued pension and retirement savings plan liabilities	481	159

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Accrued product warranties	(102)	36
Accrued restructuring expenses	709	-
Accrued other liabilities	397	(659)
Deferred income taxes payable	11	-
Deferred compensation	(36)	(110)
	-----	-----
Net cash provided (used) by operating activities	(2,145)	3,813
	-----	-----
Cash flows from investing activities:		
Proceeds from the disposition of equipment	-	2
Investment in SI-Egemin joint venture	-	(106)
Additional consideration paid in connection with Ermanco acquisition	-	(231)
Additions to property, plant and equipment	(530)	(248)
	-----	-----
Net cash used by investing activities	(530)	(583)
	-----	-----

See accompanying notes to consolidated financial statements.

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Item 1. Financial Statements (Continued)

 Paragon Technologies, Inc. and Subsidiary
 Consolidated Statements of Cash Flows (Unaudited) (Continued)
 For the Nine Months Ended September 30, 2001 and September 30, 2000
 (In Thousands, Except Share Data)

	Nine Months Ended	
	September 30, 2001	September 30, 2000
	-----	-----
Cash flows from financing activities:		
Sale of common shares in connection with employee incentive stock option plan	30	-
Repayment of long-term debt	(1,519)	(2,414)
	-----	-----
Net cash used by financing activities	(1,489)	(2,414)
	-----	-----
Increase (decrease) in cash and cash equivalents	(4,164)	816
Cash and cash equivalents, beginning of period	7,925	6,242
	-----	-----
Cash and cash equivalents, end of period	\$ 3,761	7,058
	=====	=====

Supplemental disclosures of cash flow information:

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Cash paid during the period for:		
Interest	\$ 809	1,474
	=====	=====
Income taxes	\$ 471	619
	=====	=====

Supplemental disclosures of noncash investing and financing activities:

Adjustment to excess of cost over fair value of net assets acquired due to a change in the estimated fair value of land acquired.	\$ -	70
	=====	=====

See accompanying notes to consolidated financial statements.

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Item 1. Financial Statements (Continued)

 Paragon Technologies, Inc. and Subsidiary
 Notes To Consolidated Financial Statements
 Nine Months Ended September 30, 2001 and September 30, 2000

(1) The information contained in this Form 10-Q report is unaudited. In the opinion of the management of Paragon Technologies, Inc. ("Paragon" or the "Company"), the interim financial statements furnished reflect all adjustments and accruals that are necessary to present a fair statement of results for the interim periods. The financial statements include the accounts of the Company and Ermanco Incorporated ("Ermanco"), a wholly owned subsidiary company, after elimination of intercompany balances and transactions. Results for interim periods are not necessarily indicative of results expected for the fiscal year. Refer to the Company's Form 10-K, as amended for the year ended December 31, 2000 for more complete financial information.

(2) SI/BAKER, INC.

Paragon Technologies, Inc., and McKesson Automation Systems Inc. ("McKesson Automation") are co-venturers in a joint venture named SI/BAKER, INC. ("SI/BAKER" or the "joint venture"). The SI/BAKER joint venture draws upon the automated materials handling systems experience of Paragon Technologies, Inc. and the automated pill counting and dispensing products of McKesson Automation to provide automated pharmacy systems. Each member company contributed \$100,000 in capital to fund the joint venture.

The joint venture designs and installs computer controlled, fully

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automated, integrated systems for managed care and central fill pharmacy operations. The joint venture's systems are viewed as labor saving devices, which address the issues of improved productivity and cost reduction. Systems can be expanded as customers' operations grow and they may be integrated with a wide variety of components to meet specific customer needs.

Schedule A contains the SI/BAKER, INC. financial statements. The information contained in the SI/BAKER, INC. financial statements is unaudited. In the opinion of management, the interim financial statements furnished reflect all adjustments and accruals that are necessary to present a fair statement of results for the interim periods.

(3) Ermanco Incorporated

On September 30, 1999, the Company completed the acquisition of all of the outstanding common stock of Ermanco, which now operates as a wholly-owned subsidiary of the Company. Ermanco, headquartered in Spring Lake, Michigan, designs and installs complete conveying systems for a variety of manufacturing and warehousing applications. Under the terms of the Stock Purchase Agreement, the Company acquired all of the outstanding common stock of Ermanco for a purchase price of \$22,801,000 consisting of \$15,301,000 in cash, \$3,000,000 in promissory notes payable to fourteen stockholders of Ermanco, and 481,284 shares of the Company's common stock with a value of \$4,500,000 based on the average closing price of \$9.35 of the Company's common stock for the five trading days immediately preceding the date of the Stock Purchase Agreement, August 6, 1999. The Company financed \$14,000,000 of the acquisition through term debt. The acquisition required a net cash outlay of \$2,264,000.

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements
Nine Months Ended September 30, 2001 and September 30, 2000

The acquisition was accounted for as a purchase in accordance with APB No. 16 and, accordingly, the acquired assets and assumed liabilities have been recorded at their estimated fair value at the date of acquisition. The amount of excess of cost over fair value of net assets acquired associated with the acquisition was \$18,710,000 and is being amortized over a period of 40 years.

(4) Restructuring

On June 25, 2001, the Company announced a restructuring of its business operations aimed at maximizing revenues, increasing operational efficiencies, and minimizing costs. The Company's marketing and sales operation have been consolidated to go to market as a single Company with a multiple brand, multiple channel strategy. In conjunction with the restructuring plan, the Company reduced the number of office associates by

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fourteen and will discontinue production operations at its Easton, Pennsylvania facility. All production employees working in the Easton, Pennsylvania manufacturing plant will be laid off. Layoffs began in September 2001, and will be completed on or before November 30, 2001. Prior to the restructuring, the Company employed approximately 20 production employees, with an additional 27 individuals on an extended layoff. Currently, the Company employs approximately three production employees.

In the second quarter of 2001, the Company recorded a charge of \$1,538,000 for restructuring costs. The restructuring charge included costs of \$678,000 for severance and other personnel costs, \$562,000 for pension expense associated with the curtailment of the Company's defined benefit plan for the Easton, Pennsylvania production employees, and \$298,000 for plant closure, and legal and professional service fees expected to be incurred relating to the restructuring. The restructuring charges were determined based on formal plans approved by the Company's management and the Board of Directors using the information available at the time.

The liability related to the curtailment of the defined benefit plan is recorded as accrued pension and retirement savings plan liabilities on the consolidated balance sheet. As of September 30, 2001, \$709,000 remained in the restructuring accrual. Through the third quarter of 2001, there was approximately \$267,000 in cash payments made against the restructuring accrual.

The major components of the restructuring charge and remaining accruals are as follows:

	Balance at June 30, 2001	Cash Payments	Balance at September 30, 2001
	-----	-----	-----
Severances	\$ 678,000	(239,000)	439,000
Other	298,000	(28,000)	270,000
	-----	-----	-----
	\$ 976,000	(267,000)	709,000
	=====	=====	=====

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements
Nine Months Ended September 30, 2001 and September 30, 2000

(5) Major Segments of Business

Operating segments are defined as components of an enterprise in which

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separate financial information is available and evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. On June 25, 2001, the Company announced a restructuring of its business operations aimed at maximizing revenues, increasing operational efficiencies, and minimizing costs. The Company's marketing and sales operation have been consolidated to go to market as a single Company with a multiple brand, multiple channel strategy.

The Company's Easton, Pennsylvania operations (hereafter referred to as "SI Systems") is a systems integrator supplying SI Systems' branded automated materials handling systems to manufacturing, order selection, and distribution operations. The systems are designed, sold, manufactured, installed, and serviced by its own staff or by others for SI Systems, at its direction, generally as labor-saving devices to improve productivity and reduce costs. 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' branded integrated materials handling solutions involve both standard and specially designed components and include integration of non-proprietary automated handling technologies so as to provide solutions for its customers' unique materials handling needs. SI Systems' staff develops and designs computer control programs required for the efficient operation of the systems. SI Systems' branded products are sold to customers located in North America, including the U.S. government.

The Company's Spring Lake, Michigan operations (hereafter referred to as "Ermanco") is a manufacturer of light to medium duty unit handling conveyor products, serving the materials handling industry through local independent distributors in North America. Ermanco also provides complete conveyor systems for a variety of applications, including distribution, and manufacture of computers and electronic products, utilizing primarily its own manufactured conveyor products, engineering services by its own staff or subcontractors, and subcontracted installation services. The systems product line of the Ermanco brand accounts for approximately 55% of Ermanco's total revenues, and the balance is from resale to distributors who have non-exclusive agreements with the Company.

The Company's products are sold on a fixed price basis. Generally, contract terms provide for progress payments, and a portion of the purchase price is withheld by the buyer until the system has been accepted. Generally, contract terms are net 30 days for product and parts sales, with progressive payments for system-type projects.

The Company's business is dependent upon a limited number of large contracts with certain customers. This dependence can cause unexpected fluctuations in sales volume. Along with sales recognized on the percentage of completion accounting method, the monthly rate of new orders can also vary substantially, causing fluctuations in the current backlog of orders and future revenue recognition. 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.

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 Paragon Technologies, Inc. and Subsidiary
 Notes To Consolidated Financial Statements
 Nine Months Ended September 30, 2001 and September 30, 2000

The Company identifies operating segments based on the types of products offered for sale as follows:

For the Nine Months Ended September 30, 2001 (In Thousands):	Automated Materials Handling Systems	Conveyor Systems	Total
Sales	\$ 14,751	24,196	38,947
Earnings before interest expense, interest income, equity in income of joint ventures, and income taxes (before restructuring expenses)	559	1,025	1,584
Restructuring expenses	1,538	-	1,538
Total assets	12,438	31,214	43,652
Capital expenditures	121	409	530
Depreciation and amortization expense	311	619	930

For the Nine Months Ended September 30, 2000 (In Thousands):	Automated Materials Handling Systems	Conveyor Systems	Total
Sales	\$ 23,163	25,343	48,506
Earnings before interest expense, interest income, equity in income of joint ventures, and income taxes (before restructuring expenses)	2,983	2,189	5,172
Restructuring expenses	337	-	337
Total assets	14,774	29,811	44,585
Capital expenditures	83	165	248
Depreciation and amortization expense	303	550	853

Intersegment sales for the nine months ended September 30, 2001 and September 30, 2000 totaled \$0 and \$108,000, respectively.

For the Three Months Ended September 30, 2001 (In Thousands):	Automated Materials Handling Systems	Conveyor Systems	Total
Sales	\$ 3,956	8,840	12,796
Earnings before interest expense, interest income, equity in income of joint ventures, and income taxes (before restructuring expenses)	376	586	962
Restructuring expenses	-	-	-
Total assets	12,438	31,214	43,652

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Capital expenditures	57	280	33
Depreciation and amortization expense	104	229	33

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Item 1. Financial Statements (Continued)

 Paragon Technologies, Inc. and Subsidiary
 Notes To Consolidated Financial Statements
 Nine Months Ended September 30, 2001 and September 30, 2000

For the Three Months Ended September 30, 2000 (In Thousands):	Automated Materials Handling Systems	Conveyor Systems	Total
Sales	\$ 7,942	5,531	13,473
Earnings before interest expense, interest income, equity in income of joint ventures, and income taxes (before restructuring expenses)	1,602	13	1,615
Restructuring expenses	-	-	-
Total assets	14,774	29,811	44,585
Capital expenditures	6	24	30
Depreciation and amortization expense	101	185	286

Intersegment sales for the three months ended September 30, 2001 and September 30, 2000 totaled \$0 and \$20,000, respectively.

(6) New Accounting Pronouncements

 Effective January 1, 2001, the Company adopted Financial Accounting Standard No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended (FAS 133). This standard requires that all derivative instruments be reported on the balance sheet at fair value and establishes criteria for designation and effectiveness of hedging relationships. The net cumulative effect of adopting FAS 133 as of January 1, 2001 was approximately a \$96,000 loss to accumulated other comprehensive loss.

The Company is exposed to market risk from changes in interest rates, and uses an interest rate swap to hedge this risk. The seven-year interest rate swap has a notional amount of \$5,750,000 and is classified as a cash flow hedge of forecasted variable rate interest payments on a portion of the Company's term loan. Gains and losses on the interest rate swap are deferred in other comprehensive income. The fair value of the interest rate swap at September 30, 2001 was a liability of approximately \$475,000.

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The Company uses derivative financial instruments as risk management tools and not for speculative purposes.

In July 2001, the Financial Accounting Standards Board issued Statement No. 142, "Goodwill and Other Intangible Assets." Statement 142 will require that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of Statement 142. The statement requires an evaluation of intangible assets and their useful lives and a transitional impairment test for goodwill and certain intangible assets. After transition, the impairment tests will be performed annually. The statement will be adopted beginning 2002. Because of the effort needed to comply with adopting Statement 142, it is not practicable to fully determine the impact of adopting this Statement on the Company's financial statements at this time. The Company currently records \$468,000 of goodwill amortization annually.

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements
Nine Months Ended September 30, 2001 and September 30, 2000

In August 2001, the Financial Accounting Standards Board issued FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (Statement 144), which supersedes both FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of (Statement 121) and the accounting and reporting provisions of APB Opinion No. 30, Reporting the Results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions (Opinion 30), for the disposal of a segment of a business (as previously defined in that Opinion). Statement 144 retains the fundamental provisions in Statement 121 for recognizing and measuring impairment losses on long-lived assets held for use and long-lived assets to be disposed of by sale, while also resolving significant implementation issues associated with Statement 121. For example, Statement 144 provides guidance on how a long-lived asset that is used as part of a group should be evaluated for impairment, establishes criteria for when a long-lived asset is held for sale, and prescribes the accounting for a long-lived asset that will be disposed of other than by sale. Statement 144 retains the basic provisions of Opinion 30 on how to present discontinued operations in the income statement but broadens that presentation to include a component of an entity (rather than a segment of a business). Unlike Statement 121, an impairment assessment under Statement 144 will never result in a write-down of goodwill. Rather, goodwill is evaluated for impairment under Statement No. 142, Goodwill and Other Intangible Assets.

The Company is required to adopt Statement 144 no later than the year beginning after December 15, 2001, and plans to adopt its provisions for

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the quarter ending March 31, 2002. Management does not expect the adoption of Statement 144 for long-lived assets held for use to have a material impact on the Company's financial statements because the impairment assessment under Statement 144 is largely unchanged from Statement 121.

(7) Other Comprehensive Loss

The separate components of other comprehensive loss are as follows (in thousands):

	Gross -----	Tax Effect -----	Net ---
Cumulative impact of adoption of FAS 133	\$ 165	69	96
Other comprehensive loss	310	128	182
	---	---	---
Accumulated other comprehensive loss at September 30, 2001	\$ 475	197	278
	===	===	===

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements
Nine Months Ended September 30, 2001 and September 30, 2000

(8) Long-Term Debt

As of June 30, 2001, the Company was in violation of the covenants related to its Funds Flow Coverage Ratio and its subordination agreement. Effective June 30, 2001, the Company received a waiver of certain loan covenants. On September 28, 2001, the Company entered into an amendment to the term loan and line of credit agreements relative to future covenant requirements, a variable term loan interest rate increase to LIBOR plus 3%, and limitations on the cash payment of interest on subordinated debt until the Company is in compliance with all the financial covenants as originally set forth in the Loan Agreement with the Company's principal bank.

Item 2. Management's Discussion and Analysis of Financial Condition and

Results of Operations

Liquidity and Capital Resources

The Company's cash and cash equivalents decreased to \$3,761,000 at September 30, 2001 from \$7,925,000 at December 31, 2000. The decrease resulted from cash used by operating activities totaling \$2,145,000, primarily related to payments associated with interest on acquisition financing and the Company's calendar year 2000 profit-based incentive plans. In addition, the overall decrease in cash was attributable to the repayment of long-term debt of \$1,519,000, and purchases of capital equipment totaling \$530,000. Funds provided by operating activities during the nine months ended September 30, 2000 were \$3,813,000.

On September 30, 1999, the Company completed the acquisition of all the outstanding common stock of Ermanco Incorporated ("Ermanco"). Ermanco, headquartered in Spring Lake, Michigan, designs and installs complete conveying systems for a variety of manufacturing and warehousing applications.

In order to complete the Ermanco acquisition, the Company obtained financing from its principal bank. The Company entered into a new three-year line of credit facility which may not exceed the lesser of \$6,000,000 or an amount based on a borrowing base formula tied principally to accounts receivable, inventory, fair market value of the Company's property and plant, and liquidation value of equipment. This amount will be reduced by the unpaid principal balance of the term loan described below. The line of credit facility is to be used primarily for working capital purposes. As of September 30, 2001, the Company did not have any borrowings under the line of credit facility.

The Company financed \$14,000,000 of the acquisition through a seven-year term loan from its bank. During the first two years of the term loan, the Company was obligated to repay equal quarterly payments of \$312,500 plus accrued interest. After September 30, 2001, the Company will make equal quarterly payments of \$575,000, plus interest until the loan has been fully repaid. The interest rate on the term loan is variable at a rate equal to the three-month LIBOR Market Index Rate plus three percent, which was 5.6% as of September 30, 2001. The Company also entered into an interest rate swap agreement for a portion of the term loan to hedge the floating interest rate. The seven-year interest rate swap for \$5,750,000 is at a fixed rate of 9.38%. During the second quarter of fiscal 2001, the Company prepaid, without penalty, \$575,000 of the term loan. Also, on July 27, 2000, the Company prepaid, without penalty, \$1,150,000 of the term loan. Therefore, since the inception of the term loan, the Company prepaid, without penalty, \$1,725,000 of the term loan.

To obtain the line of credit and term loan, the Company granted the bank a security interest in all personal property, including, without limitation, all accounts, deposits, documents, equipment, fixtures, general intangibles, goods, instruments, inventory, letters of credit, money, securities, and a first mortgage on all real estate. The line of

Item 2. Management's Discussion and Analysis of Financial Condition and

Results of Operations

Liquidity and Capital Resources (Continued)

credit facility and term loan contain various restrictive covenants relating to

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additional indebtedness, asset acquisitions or dispositions, investments, guarantees, payment of dividends, and maintenance of certain financial ratios. As of September 30, 2001, the Company was in compliance with all covenants, as amended (see Note 8).

The Company also issued promissory notes to fourteen stockholders of Ermanco in the aggregate principal amount of \$3,000,000. The notes have a term of seven years and bear interest at an annual rate of ten percent in years one through three, twelve percent in years four and five, and fourteen percent in years six and seven. The weighted average interest rate on the promissory notes is 11.714% over the term of the notes. Interest shall be payable quarterly, in cash or under certain conditions, in the Company's common stock upon approval of the Company's Board of Directors. The promissory notes may be prepaid prior to the end of the seven-year term provided that there is no debt outstanding under its line of credit facility and term loan. Since July 1, 2001, the Company has been and will be prohibited from making any cash payments of subordinated debt and interest until the Company is in full compliance with all the financial covenants as originally set forth in the Loan Agreement with the Company's principal bank. The Company intends to satisfy its quarterly interest obligations with the issuance of the Company's common stock.

On March 4, 1996, SI/BAKER established a line of credit facility (the "facility") with its principal bank (the "bank"). Under the terms of the \$3,000,000 facility, SI/BAKER's parent companies, Paragon Technologies, Inc. and McKesson Automation Systems Inc., have each provided a limited guarantee and surety in an amount not to exceed \$1,000,000 for a combined guarantee of \$2,000,000 to the bank for the payment and performance of the related note, including any further renewals or modifications of the facility. As of September 30, 2001, SI/BAKER did not have any borrowings under the facility, and the facility expires effective August 31, 2002.

The Company anticipates that its financial resources, consisting of borrowings under its credit facility and cash generated from operations, will be adequate to satisfy its future cash requirements through the next twelve months. Due to the unpredictability of future contract sales, the dependence upon a limited number of large contracts with certain customers, sales volume, as well as cash liquidity, may experience fluctuations. For these reasons, cash liquidity beyond a twelve-month period is difficult for the Company to forecast with reasonable accuracy.

The Company plans to consider expansion opportunities as they arise, although ongoing operating results of the Company, the restrictive covenants associated with the financing obtained from the Company's principal bank, the economics of the expansion, and the circumstances justifying the expansion will be key factors in determining the amount of resources the Company will devote to further expansion. The Company did not have any material capital commitments as of September 30, 2001.

Item 2. Management's Discussion and Analysis of Financial Condition and

Results of Operations

Results Of Operations

(a) Nine Months Ended September 30, 2001 Versus Nine Months Ended September 30,

2000

Net sales of \$38,947,000 for the nine months ended September 30, 2001 decreased 19.7% compared to net sales of \$48,506,000 for the nine months ended September 30, 2000, primarily due to the current economic slowdown. The sales decrease for the nine months ended September 30, 2001 was primarily experienced by the Company's SI Systems' brand, which encountered an equivalent reduction in sales among all of its product lines, when compared to the nine months ended September 30, 2000. The Company's business is dependent upon a limited number of large contracts with certain customers. This dependence can cause unexpected fluctuations in sales volume. Along with sales recognized on the percentage of completion accounting method, the monthly rate of new orders can also vary substantially, causing fluctuations in the current backlog of orders and future revenue recognition. 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.

Gross profit, as a percentage of sales, was 25.6% for the nine months ended September 30, 2001 compared to 27.1% for the nine months ended September 30, 2000. Gross profit on sales for the nine months ended September 30, 2001 was favorably impacted by the reversal of approximately \$720,000 in previously established contract accruals due to changes in cost estimates. Gross profit on sales for the nine months ended September 30, 2000 was impacted by the favorable performance on several contracts, principally for the Company's higher margin proprietary product lines, initiated in the prior fiscal year that were completed or nearing completion during the nine months ended September 30, 2000. Partially offsetting the impact of the favorable performances on several contracts was the recognition of additional losses, primarily during the second quarter of fiscal 2000, on a major contract where significant cost overruns, resulting in losses, were experienced.

Selling, general and administrative expenses of \$7,899,000 were higher by \$135,000 for the nine months ended September 30, 2001 than in the nine months ended September 30, 2000. The increase is primarily attributable to approximately \$310,000 of charges during the second quarter of 2001 related to a strategic transaction that was not completed, and approximately \$175,000 of expenses during the first quarter of 2001 pertaining to the reduction of associates due to the current economic slowdown. Partially offsetting the increase were costs savings attributable to the Company's restructuring of its business operations and continued emphasis on cost reduction.

Product development costs of \$402,000 were higher by \$265,000 for the nine months ended September 30, 2001 than in the nine months ended September 30, 2000. Development programs in the nine months ended September 30, 2001 included enhancements to the Company's Order Picking, Fulfillment, and Replenishment product line and also development efforts related to NBS 30(TM), NBS 90(TM), and NBS 90-SP(TM) narrow belt sorters. Development progress in the nine months ended September 30, 2000 included enhancements to the Company's conveyor technology, and horizontal transportation and Order Picking, Fulfillment, and Replenishment product lines.

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During the second quarter ended June 30, 2001, the Company announced a restructuring of its business operations and recorded a charge of \$1,538,000 for restructuring costs. In conjunction with the restructuring plan, the Company reduced the number of office associates by fourteen and will discontinue production operations at its Easton, Pennsylvania facility. All production employees working in the Easton, Pennsylvania manufacturing plant will be laid off. Layoffs began in September 2001, and will be completed on or before November 30, 2001. Prior to the restructuring, the Company employed approximately twenty production employees, with an additional 27 individuals on an extended layoff. The Company currently employs approximately three

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Item 2. Management's Discussion and Analysis of Financial Condition and

Results of Operations

Results Of Operations

(a) Nine Months Ended September 30, 2001 Versus Nine Months Ended September 30,

2000 (Continued)

production employees. The restructuring charges included costs of \$678,000 for severance and other personnel costs, \$562,000 for pension expense associated with the curtailment of the Company's defined benefit plan for the Company's Easton, Pennsylvania collective bargaining personnel, and \$298,000 for facility closure, and legal and professional service fees expected to be incurred relating to the restructuring. The restructuring charges were determined based on formal plans approved by the Company's management and the Board of Directors using the information available at the time.

Restructuring expenses of \$337,000 for the nine months ended September 30, 2000 was associated with a restructuring initiative, whereby the Company reduced the number of associates by sixteen.

Interest expense of \$1,001,000 was lower by \$236,000 for the nine months ended September 30, 2001 than in the nine months ended September 30, 2000. The decrease in interest expense was attributable to the reduced level of term debt due to principal prepayments and lower interest rates.

Interest income of \$215,000 for the nine months ended September 30, 2001 decreased by \$47,000, when compared to the nine months ended September 30, 2000. The decrease in interest income was attributable to a reduction in the level of funds and interest rates pertaining to short-term investments.

Equity in income of joint ventures represents the Company's proportionate share of its investments in the SI-Egemin and SI/BAKER joint ventures that are being accounted for under the equity method. The net favorable variance of \$257,000 in the equity in income of joint ventures for the nine months ended September 30, 2001 as compared to the nine months ended September 30, 2000 was comprised of increased earnings of approximately \$163,000 attributable to the SI/BAKER joint venture. In addition to the increased earnings of the SI/BAKER joint venture were the decreased losses of approximately \$94,000 attributable to the SI-Egemin joint venture.

The favorable variance of \$163,000 for the nine months ended September 30, 2001 in the equity in income of the SI/BAKER joint venture was attributable to favorable performance on several contracts initiated in prior fiscal years that were completed or nearing completion during the nine months ended September 30,

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2001 plus (1) a reduction of \$48,000 in revenue-based royalty costs due to the parent companies, and (2) an increase of \$47,000 in interest income. Partially offsetting these favorable variances was an increase of \$223,000 in product development expenses.

The favorable variance of \$94,000 for the nine months ended September 30, 2001 in the equity in income of the SI-Egemin joint venture was primarily attributable to a reduction in operating expenses of the joint venture.

The Company recognized an income tax benefit of \$155,000 during the nine months ended September 30, 2001, compared to the incurrence of income tax expense of \$1,571,000 in the comparable prior year period. The income tax benefit recognized for the nine months ended September 30, 2001 represented the carryback of current fiscal year losses against prior year income. Income tax expense for the nine months ended September 30, 2000 was generally recorded at statutory federal and state tax rates expected to apply for that fiscal year.

The total backlog at September 30, 2001 was approximately \$16,530,000. During the nine months ending September 30, 2001, the Company received orders totaling approximately \$32,565,000.

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Item 2. Management's Discussion and Analysis of Financial Condition and

Results of Operations

Results Of Operations

(b) Three Months Ended September 30, 2001 Versus Three Months Ended September

30, 2000

With the exception of the following Statement of Operations captions, changes in the third quarter of calendar year 2001 compared to the prior year were consistent with those previously noted above for the nine-month period.

Net sales of \$12,796,000 for the three months ended September 30, 2001 decreased 5.0% compared to net sales of \$13,473,000 for the three months ended September 30, 2000, primarily due to the current economic slowdown. The sales decrease for the three months ended September 30, 2001 was experienced by the Company's SI Systems' brand. Partially offsetting the decline in SI Systems' brand sales for the three months ended September 30, 2001 was an increase in sales for the Company's Ermanco brand, primarily to distributors and a technology firm, when compared to the three months ended September 30, 2000.

Selling, general and administrative expenses of \$2,213,000 were lower by \$293,000 for the three months ended September 30, 2001 than in the three months ended September 30, 2000. The decrease in selling, general and administrative expenses is primarily attributable to decreases of approximately \$210,000 of those expenses based on revenue and profit performance, and approximately \$70,000 of product promotion and marketing expenses.

Cautionary Statement

Certain statements contained herein are not based on historical fact and

are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 or by the Securities and Exchange Commission rules, regulations, and releases. The Company intends that such forward-looking statements be subject to the safe harbors created thereby. Among other things, they regard the Company's acquisition activities, earnings, liquidity, financial condition, and certain operational matters. Words or phrases denoting the anticipated results of future events, such as "anticipate," "believe," "estimate," "expect," "may," "will," "will likely," "are expected to," "will continue," "should," "project," and similar expressions that denote uncertainty, are intended to identify such forward-looking statements. The Company's actual results, performance, or achievements could differ materially from the results expressed in, or implied by, such "forward-looking statements": (1) as a result of risks and uncertainties identified in connection with those forward-looking statements, including those factors identified herein, and in the Company's other publicly filed reports; (2) as a result of risks associated with the Company's restructuring, including the failure to achieve anticipated operating savings, and the possibility that the restructuring charges will be greater than anticipated; (3) as a result of factors over which the Company has no control, including the strength of domestic and foreign economies, sales growth, competition, and certain costs increases; (4) if the factors on which the Company's conclusions are based do not conform to the Company's expectations.

Item 2. Management's Discussion and Analysis of Financial Condition and

Results of Operations

Quantitative and Qualitative Disclosures

The Company's primary market risk exposure is from changes in interest rates. The Company's policy is to manage interest rate exposure through the use of a combination of fixed and floating rate debt instruments, and since September 30, 1999, an interest rate swap agreement. Generally, the Company seeks to match the terms of its debt with its purpose. The Company uses a variable rate line of credit facility to provide working capital for operations. On September 30, 1999, the Company entered into an interest rate swap agreement for its new term loan from its principal bank to effectively convert a portion of the term loan from a variable rate note to a fixed rate note. A standard interest rate swap agreement involves the payment of a fixed rate times a notional amount by one party in exchange for a floating rate times the same notional amount from another party. The counterpart to the swap agreement is the Company's principal bank.

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

PART II -- OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits-- None.

(b) No reports on Form 8-K were filed during the quarter ended September 30, 2001.

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Paragon Technologies, Inc. and Subsidiary

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PARAGON TECHNOLOGIES, INC.

/S/ William R. Johnson

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William R. Johnson
President & CEO

/S/ Ronald J. Semanick

Ronald J. Semanick
Chief Financial Officer

Dated: November 14, 2001

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Financial Statements
September 30, 2001

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SI/BAKER, INC.
Balance Sheets
September 30, 2001 and December 31, 2000
(In Thousands, Except Share Data)

	(UNAUDITED) September 30, 2001	December 31, 2000
	-----	-----
Assets		

Current assets:		
Cash and cash equivalents, principally time deposits	\$ 3,969	4,681
Receivables:		
Trade	2,398	1,001
Other receivables	209	65
	-----	-----
Total receivables	2,607	1,066
	-----	-----

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Costs and estimated earnings in excess of billings	530	1,873
Deferred income tax benefits	409	409
Prepaid expenses and other current assets	121	36
	-----	-----
Total current assets	7,636	8,065
	-----	-----
Machinery and equipment, at cost	258	222
Less: accumulated depreciation	170	147
	-----	-----
Net machinery and equipment	88	75
	-----	-----
Equipment leased to customer	-	487
Less: accumulated depreciation	-	487
	-----	-----
Net equipment leased to customer	-	-
	-----	-----
Deferred income tax benefits	8	8
	-----	-----
Total assets	\$ 7,732	8,148
	=====	=====

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SI/BAKER, INC.
Balance Sheets
September 30, 2001 and December 31, 2000
(In Thousands, Except Share Data)

(UNAUDITED)	
September 30,	December 31,
2001	2000
-----	-----

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Liabilities and Stockholders' Equity

Current liabilities:

Accounts payable:		
Trade	\$ 478	663
Affiliated companies	104	56
	-----	-----
Total accounts payable	582	719
	-----	-----
Customers' deposits and billings in excess of costs and estimated earnings	1,082	1,459
Accrued salaries, wages, and commissions	310	358
Income taxes payable	7	127
Accrued royalties payable	131	766
Accrued product warranties	1,111	1,055
Accrued other liabilities	60	88
	-----	-----
Total current liabilities	3,283	4,572
	-----	-----

Stockholders' equity:

Common stock, \$1 par value; authorized 1,000 shares; issued 200 shares	-	-
Additional paid-in capital	200	200
Retained earnings	4,249	3,376
	-----	-----
Total stockholders' equity	4,449	3,576
	-----	-----
Total liabilities and stockholders' equity	\$ 7,732	8,148
	=====	=====

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(In Thousands)

	Three Months Ended		Nine Months Ended	
	September 30, 2001	September 30, 2000	September 30, 2001	September 2000
Net sales	\$ 3,266	2,714	9,515	10,732
Cost of sales	2,405	2,149	6,844	8,817
	-----	-----	-----	-----
Gross profit on sales	861	565	2,671	1,915
	-----	-----	-----	-----
Selling, general and administrative expenses	252	206	799	748
Product development costs	32	10	308	85
Royalty expense to parent companies	131	109	381	429
Interest income	(36)	(24)	(142)	(95)
Other income, net	(60)	(47)	(130)	(143)
	-----	-----	-----	-----
	319	254	1,216	1,024
	-----	-----	-----	-----
Earnings before income taxes	542	311	1,455	891
Income tax expense	217	114	582	344
	-----	-----	-----	-----
Net earnings	\$ 325	197	873	547
	=====	=====	=====	=====

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SI/BAKER, INC.

Statements of Cash Flows (Unaudited)

For the Nine Months Ended September 30, 2001 and September 30, 2000

(In Thousands)

	Nine Months Ended	
	September 30, 2001	September 30, 2000
Cash flows from operating activities:		
Net earnings	\$ 873	547
Adjustments to reconcile net earnings to net cash used by operating activities:		
Depreciation of machinery and equipment and leased equipment	23	43
Changes in operating assets and liabilities:		
Receivables	(1,541)	(466)
Costs and estimated earnings in excess of billings	1,343	381
Prepaid expenses and other current assets	(85)	(51)
Accounts payable	(137)	(283)
Customers' deposits and billings in excess of costs and estimated earnings	(377)	(437)
Accrued salaries, wages, and commissions	(48)	(73)
Income taxes payable	(120)	(97)
Accrued royalties payable	(635)	164
Accrued product warranties	56	151
Accrued other liabilities	(28)	(4)
Net cash used by operating activities	(676)	(125)
Cash flows from investing activities:		
Additions to machinery and equipment	(36)	(25)
Net cash used by investing activities	(36)	(25)
Decrease in cash and cash equivalents	(712)	(150)
Cash and cash equivalents, beginning of period	4,681	2,895
Cash and cash equivalents, end of period	\$ 3,969	2,745
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		

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Income taxes	\$	739	10
		=====	=====
Interest	\$	-	-
		=====	=====