PARAGON TECHNOLOGIES INC
Form 10-Q
August 14, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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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 June 30, 2003

Commission File No. 1-15729

PARAGON TECHNOLOGIES, INC.
(Exact Name Of Registrant As Specified In Its Charter)

Delaware	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

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No X

Number of shares of common stock, par value $1.00 per share, outstanding as of August 5, 2003: 4,277,095.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statement

Paragon Technologies, Inc. and Subsidiary
Consolidated Balance Sheets
June 30, 2003 and December 31, 2002
(In Thousands, Except Share Data)

	(UNAUDITED) June 30, 2003	December 31, 2002
Assets		
Current assets:		
Cash and cash equivalents	$ 4,501	5,385
Restricted cash	-	865
Receivables:		
Trade (net of allowance for doubtful accounts of $277 as of June 30, 2003 and $221 as of December 31, 2002)	5,855	4,285
Notes and other receivables	130	940
Total receivables	5,985	5,225
Costs and estimated earnings in excess of billings	666	128
Inventories:		
Raw materials	1,266	975
Work-in-process	104	109

Finished goods	142	291
Total inventories	1,512	1,375
Deferred income tax benefits	1,410	1,771
Prepaid expenses and other current assets	510	695
Total current assets	14,584	15,444
Property, plant and equipment, at cost:		
Land	-	27
Buildings and improvements	228	3,768
Machinery and equipment	3,794	4,291
	4,022	8,086
Less: accumulated depreciation	2,498	5,877
Net property, plant and equipment	1,524	2,209
Investment in joint venture	576	1,325
Goodwill	17,657	17,657
Other assets, at cost less accumulated amortization of $183 as of June 30, 2003 and $143 as of December 31, 2002	28	68
Total assets	$ 34,369	36,703

See accompanying notes to consolidated financial statements.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Consolidated Balance Sheets
June 30, 2003 and December 31, 2002
(In Thousands, Except Share Data)

	(UNAUDITED) June 30, 2003	December 31, 2002
Liabilities and Stockholders' Equity		
Current liabilities:		
Current installments of long-term debt	$ 1,150	1,437
Accounts payable	3,217	2,403

Customers' deposits and billings in excess of costs and estimated earnings	1,817	2,271
Accrued salaries, wages, and commissions	463	544
Income taxes payable	445	154
Accrued royalties payable	110	114
Accrued product warranties	946	894
Accrued pension and retirement savings plan liabilities	42	170
Accrued restructuring expenses	182	216
Deferred gain on sale-leaseback	165	-
Accrued other liabilities	1,084	1,269
Total current liabilities	9,621	9,472
Long-term liabilities:		
Long-term debt, excluding current installments:		
Term loan	575	4,263
Subordinated notes payable	2,000	3,000
Total long-term debt	2,575	7,263
Other long-term liability	335	401
Deferred gain on sale-leaseback	605	-
Deferred income taxes payable	1,595	1,713
Deferred compensation	33	25
Total long-term liabilities	5,143	9,402
Stockholders' equity:		
Common stock, $1 par value; authorized 20,000,000 shares; issued and outstanding 4,277,095 shares as of June 30, 2003 and 4,256,098 shares as of December 31, 2002	4,277	4,256
Additional paid-in capital	7,583	7,313
Retained earnings	7,949	6,504
Accumulated other comprehensive loss	(204)	(244)
Total stockholders' equity	19,605	17,829
Total liabilities and stockholders' equity	$ 34,369	36,703

See accompanying notes to consolidated financial statements.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Consolidated Statements of Operations (Unaudited)

For the Three and Six Months Ended June 30, 2003 and 2002
(In Thousands, Except Share And Per Share Data)

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Net sales................	$ 10,983	9,908	19,547	20,660
Cost of sales............	8,059	7,422	14,419	15,285
Gross profit on sales.....	2,924	2,486	5,128	5,375
Selling, general and administrative expenses...............	1,874	2,182	3,871	4,523
Product development costs..................	139	93	302	159
Restructuring charges (credit)..............	-	-	(170)	-
Interest expense..........	151	266	369	538
Interest income...........	(22)	(17)	(46)	(53)
Equity in income of joint venture..........	(89)	(36)	(251)	(42)
Other income, net.........	(124)	(203)	(1,620)	(524)
	1,929	2,285	2,455	4,601
Earnings before income taxes...........	995	201	2,673	774
Income tax expense........	378	78	1,045	308
Net earnings.............	$ 617	123	1,628	466
Basic earnings per share.............	$ .14	.03	.38	.11
Diluted earnings per share.............	$ .14	.03	.38	.11
Weighted average shares outstanding.....	4,266,799	4,226,635	4,262,213	4,224,492
Dilutive effect of stock options..........	89,955	52,695	78,021	70,194
Dilutive effect of phantom stock units....	-	-	-	6,703
Weighted average shares outstanding assuming dilution......	4,356,754	4,279,330	4,340,234	4,301,389

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See accompanying notes to consolidated financial statements.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Consolidated Statements of Comprehensive Income (Unaudited)
For the Three and Six Months Ended June 30, 2003 and 2002
(In Thousands)

	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Net earnings................	$ 617	123	1,628	466
Other comprehensive income (loss), net of tax:				
Interest rate swap:				
Change in fair value of derivative, net of tax.............	-	3	(8)	44
Total other comprehensive income (loss)...	-	3	(8)	44
Comprehensive income..........	$ 617	126	1,620	510

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 Six Months Ended June 30, 2003 and 2002
(In Thousands, Except Share Data)

	Six Months Ended	
	June 30, 2003	June 30, 2002
Cash flows from operating activities:		
Net earnings	$ 1,628	466
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation of plant and equipment.............	283	320
Amortization of intangibles.....................	40	20
Gain on disposition of property, plant and equipment, net of unearned profit on sale-leaseback......................	(1,361)	(108)
Amortization of deferred gain on sale-leaseback..................................	(56)	-
Restructuring credit............................	(170)	-
Cash dividend received from joint venture........	1,000	-
Equity in income of joint venture................	(251)	(42)
Issuance of common shares as interest payment on subordinated notes.................	90	-
Change in operating assets and liabilities:		
Receivables.................................	(760)	(125)
Costs and estimated earnings in excess of billings......................	(538)	99
Inventories.................................	(137)	348
Deferred income tax benefits................	361	-
Prepaid expenses and other current assets..........................	185	216
Accounts payable............................	814	(472)
Customers' deposits and billings in excess of costs and estimated earnings for completed and uncompleted contracts....................	(454)	982
Accrued salaries, wages, and commissions............................	(81)	(36)
Income taxes payable........................	291	9
Accrued royalties payable...................	(4)	5
Accrued pension and retirement savings plan liabilities.................	42	16
Accrued product warranties..................	52	291
Accrued restructuring expenses..............	(34)	(226)
Accrued other liabilities...................	(174)	69
Deferred income taxes payable	(145)	-
Deferred compensation.......................	8	(119)
Net cash provided by operating activities...........	629	1,713
Cash flows from investing activities:		
Proceeds from the disposition of property, plant and equipment	2,734	198
Proceeds from the divestment of a joint venture....................................	-	125
Additions to property, plant and equipment..........	(145)	(174)

Net cash provided by investing activities	2,589	149

See accompanying notes to consolidated financial statements.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Consolidated Statements of Cash Flows (Unaudited) (Continued)
For the Six Months Ended June 30, 2003 and 2002
(In Thousands, Except Share Data)

	Six Months Ended	
	June 30, 2003	June 30, 2002
Cash flows from financing activities:		
Sale of common shares in connection with employee incentive stock option plan	8	33
Decrease in restricted cash	865	-
Repayment of long-term debt	(4,975)	(1,155)
Net cash used by financing activities	(4,102)	(1,122)
Increase (decrease) in cash and cash equivalents	(884)	740
Cash and cash equivalents, beginning of period	5,385	6,114
Cash and cash equivalents, end of period	$ 4,501	6,854
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest	$ 293	417
Income taxes	$ (370)	45

See accompanying notes to consolidated financial statements.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements
For the Three and Six Months Ended June 30, 2003 and 2002

(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. This quarterly report should be read in conjunction with, and is qualified in its entirety by reference to, the Consolidated Financial Statements of the Company and the related Notes thereto appearing in our annual report on Form 10-K for the year ended December 31, 2002 as filed with the Securities and Exchange Commission. Refer to the Company's Form 10-K for the year ended December 31, 2002 for more complete financial information.

(2) Restructuring

In June 2001, the Company restructured its business operations, including curtailment of a defined benefit plan, and recorded a charge of $1,538,000 for restructuring costs. The Company received approval from the Pension Benefit Guaranty Corporation in 2002 to terminate the defined benefit plan. In December 2002, the Company partially settled its obligations by making lump-sum distributions to those participants who elected that payment option and correspondingly recorded a restructuring credit of $859,000. In February 2003, the Company settled its remaining obligations by purchasing annuities for those participants who elected that payment option and correspondingly recorded a restructuring credit of $170,000.

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

	Beginning Balance January 1	Charge/ (Credit)	Cash Spending	Reclassification	Ending Balance June 30
2003............	$ 216	(170)	(34)	170	182
2002............	$ 494	-	(226)	-	268

The $182,000 restructuring accrual at June 30, 2003 relates to severance and other personnel costs and professional fees for the 2001 restructuring that are still expected to be paid.

The amount reclassified out of the restructuring accrual was previously included in accrued pension and retirement savings plan liabilities.

(3) Warranty

The Company's products are warranted against defects in materials and workmanship for a specified period. The Company provides an accrual for estimated future warranty costs and potential product liability claims based upon a percentage of cost of sales and warranty experience.

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements
For the Three and Six Months Ended June 30, 2003 and 2002

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

	Beginning Balance January 1	Additions	Deductions	Ending Balance June 30
2003............	$ 894	168	(116)	946
2002............	$ 863	408	(117)	1,154

Deductions include payments of warranty costs and reversal of unused expired warranty accruals.

(4) Major Segments of Business

Operating segments are defined as components of an enterprise in which separate financial information is available and evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company identified such segments based on both management responsibility and types of products offered for sale. The Company operates in two major market segments.

SI Systems

The Company's Easton, Pennsylvania operations (hereafter referred to as "SI Systems") is a specialized systems integrator supplying SI Systems' branded automated material handling systems to manufacturing, assembly, order selection, and distribution operations. The systems are marketed, designed, sold, installed, and serviced by its own staff or agents, generally as labor-saving devices to improve productivity, quality, and reduce costs. SI Systems also operates as a project manager in connection with the installation, integration, and service of its products generally utilizing subcontractors. 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 material handling solutions involve both standard and specially designed components and include integration of non-proprietary automated handling technologies so as to provide turnkey solutions for its customers' unique material handling needs. SI Systems' staff develops and designs computer control programs required for the efficient operation of its systems and for optimizing distribution operations. SI Systems' branded products are sold to customers located primarily in North America, including the U.S. government.

Ermanco

The Company's Spring Lake, Michigan operations (hereafter referred to as "Ermanco") is a manufacturer of Ermanco branded light to medium duty unit handling conveyor and sortation products, serving the material handling industry through a worldwide network of approximately 100 experienced material handling equipment distributors and licensees. 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. Ermanco supplies material handling systems and equipment to both national and international markets. Ermanco offers services ranging from the delivery of basic transportation conveyors to turnkey installations of complex, fully

automated work-in-process production lines and distribution centers, utilizing sophisticated, custom-designed controls software. Many of Ermanco's sales are to distributors who have non-exclusive agreements with the Company.

The Company's systems vary in configuration and capacity. Historically, system prices across the Company's product lines have ranged from $100,000 to several million dollars per system. Systems and aftermarket sales by brand during the three and six months ended June 30, 2003 and 2002 are as follows (in thousands):

For the three months ended June 30, 2003:

	SI Systems	Ermanco	Total	% of Total Sales
Systems sales................	$ 2,270	7,548	9,818	89.4%
Aftermarket sales............	756	409	1,165	10.6%
Total sales..................	$ 3,026	7,957	10,983	100.0%
As a % of total sales........	27.6%	72.4%	100.0%	

For the three months ended June 30, 2002:

	SI Systems	Ermanco	Total	% of Total Sales
Systems sales................	$ 2,665	5,808	8,473	85.5%
Aftermarket sales............	856	579	1,435	14.5%
Total sales..................	$ 3,521	6,387	9,908	100.0%
As a % of total sales........	35.5%	64.5%	100.0%	

For the six months ended June 30, 2003:

	SI Systems	Ermanco	Total	% of Total Sales
Systems sales................	$ 4,877	12,325	17,202	88.0%
Aftermarket sales............	1,521	824	2,345	12.0%
Total sales..................	$ 6,398	13,149	19,547	100.0%
As a % of total sales........	32.7%	67.3%	100.0%	

For the six months ended June 30, 2002:

	SI Systems	Ermanco	Total	% of Total Sales
Systems sales................	$ 5,705	12,197	17,902	86.7%
Aftermarket sales............	1,715	1,043	2,758	13.3%
Total sales..................	$ 7,420	13,240	20,660	100.0%
As a % of total sales........	35.9%	64.1%	100.0%	

The Company's products are sold worldwide through its own sales personnel, along with a network of independent distributors and licensees. Domestic and international sales by brand during the three and six months ended June 30, 2003 and 2002 are as follows (in thousands):

For the three months ended June 30, 2003:

	SI Systems	Ermanco	Total	% of Total Sales
Domestic sales..............	$ 2,561	7,270	9,831	89.5%
International sales..........	465	687	1,152	10.5%
Total sales.................	$ 3,026	7,957	10,983	100.0%

For the three months ended June 30, 2002:

	SI Systems	Ermanco	Total	% of Total Sales
Domestic sales..............	$ 3,459	5,689	9,148	92.3%
International sales..........	62	698	760	7.7%
Total sales.................	$ 3,521	6,387	9,908	100.0%

For the six months ended June 30, 2003:

	SI Systems	Ermanco	Total	% of Total Sales
Domestic sales..............	$ 5,844	12,236	18,080	92.5%
International sales..........	554	913	1,467	7.5%
Total sales.................	$ 6,398	13,149	19,547	100.0%

For the six months ended June 30, 2002:

	SI Systems	Ermanco	Total	% of Total Sales
Domestic sales..............	$ 7,268	12,176	19,444	94.1%
International sales..........	152	1,064	1,216	5.9%
Total sales.................	$ 7,420	13,240	20,660	100.0%

The Company also engages in sales with the U.S. government, which is one of the Company's major customers. Sales to the U.S. government during the three and six months ended June 30, 2003 and 2002 are as follows (in thousands):

		As a % of Total Sales
For the three months ended June 30, 2003	$ 396	3.6%
For the three months ended June 30, 2002	1,207	12.2%
For the six months ended June 30, 2003	$ 520	2.7%
For the six months ended June 30, 2002	2,726	13.2%

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

For the Three Months Ended June 30, 2003 (In Thousands):	SI Systems	Ermanco	Total
Sales	$ 3,026	7,957	10,983
Earnings before interest expense, interest income, equity in income of joint venture, and income taxes	183	852	1,035
Total assets	5,214	29,155	34,369
Capital expenditures	8	15	23
Depreciation and amortization expense	35	101	136

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements
For the Three and Six Months Ended June 30, 2003 and 2002

For the Three Months Ended June 30, 2002 (In Thousands):	SI Systems	Ermanco	Total
Sales	$ 3,521	6,387	9,908
Earnings (loss) before interest expense, interest income, equity in income of joint venture, and income taxes	422	(8)	414
Total assets	10,524	30,682	41,206
Capital expenditures	6	96	102
Depreciation and amortization expense	60	100	160

For the Six Months Ended June 30, 2003 (In Thousands):	SI Systems	Ermanco	Total

Sales	$ 6,398	13,149	19,547
Earnings before interest expense, interest income, equity in income of joint venture, and income taxes	1,769	976	2,745
Total assets	5,214	29,155	34,369
Capital expenditures	34	111	145
Depreciation and amortization expense	82	201	283

For the Six Months Ended June 30, 2002 (In Thousands):	SI Systems	Ermanco	Total
Sales	$ 7,420	13,240	20,660
Earnings before interest expense, interest income, equity in income of joint venture, and income taxes	1,119	98	1,217
Total assets	10,524	30,682	41,206
Capital expenditures	21	153	174
Depreciation and amortization expense	120	200	320

All of the Company's sales originate in the United States, and there are no long-lived assets existing outside the United States.

(5) New Accounting Pronouncements

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("FAS 146") which addresses financial accounting and reporting for costs associated with exit or disposal activities. This Statement nullifies Emerging Issues Task Force Issue 94-3. "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred and establishes that fair value is the objective for initial measurement of the liability. The Statement is effective for exit or disposal activities that are initiated after December 31, 2002. The application of FAS 146 did not have an effect on the Company's financial statements.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others." This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002 and did not have an effect on the Company's financial statements. The disclosure requirements were effective for the Company's 2002 financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities," which addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities entered into after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. The application of this Interpretation did not have an effect on the Company's financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity ("FAS 150"). FAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It applies specifically to a number of financial instruments that companies have historically presented within their financial statements either as equity or between the liabilities section and the equity section, rather than as liabilities. FAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The application of FAS 150 is not expected to have a material impact on the Company's financial statements.

(6) 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 interest rate swap has a notional amount of $3,737,500 and expires in 2006. Prior to April 1, 2003, gains and losses on the interest rate swap were deferred in other comprehensive income (loss). Effective April 1, 2003, the Company de-designated the interest rate swap as a hedge of market risk from changes in interest rates and accordingly, all gains and losses on the interest rate swap are recorded as interest expense. The fair value of the interest rate swap at June 30, 2003 was a liability of approximately $335,000.

	Gross	Tax Effect	Net
Accumulated other comprehensive loss at December 31, 2002..................	$(401)	(157)	(244)
Loss reclassified from other comprehensive income......................	113	43	70
Amortization of other comprehensive income......................	26	10	16
Change in fair value of derivative............	(73)	(27)	(46)

Accumulated other comprehensive loss at June 30, 2003......................	$(335)	(131)	(204)
	===	===	===

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

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements
For the Three and Six Months Ended June 30, 2003 and 2002

(7) Sale-Leaseback

In February 2003, the Company sold its Easton, Pennsylvania facility. Significant terms of the agreement of sale include a sales price of $2,925,000 and a leaseback of 25,000 square feet of office space for five years by the Company. The sale-leaseback resulted in a gain of $2,189,000, of which $1,363,000 of the gain was recorded in Other income in the Statement of Operations for the three months ended March 31, 2003. The remaining gain of $826,000 is deferred and will be recognized as a reduction in rent expense over the term of the lease. During the three and six months ended June 30, 2003, $40,000 and $56,000, respectively, of the deferred gain was recognized. Future contractual obligations over the remaining term of the lease are as follows:

2003..............................	$ 103,000
2004..............................	211,000
2005..............................	218,000
2006..............................	224,000
2007..............................	231,000
2008..............................	34,000

Total............................	$ 1,021,000
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(8) Long-Term Debt

The Company was in violation of the covenant related to its Funds Flow Coverage Ratio and received waivers from its principal bank for the covenant violation for the quarters ended June 30, 2002 and September 30, 2002. During August 2002, the Company entered into an arrangement to amend its credit agreements with its principal bank relative to future covenant requirements and the maintenance of a minimum cash balance covenant. In August 2002, the line of credit agreement was amended to extend the expiration date of the facility and decrease the amount available under the facility. During November 2002, the Company prepaid, without penalty, $1,200,000 of the term loan reducing the balance of the term loan to $5,987,500 and placed $1,150,000 in escrow with the Company's principal bank. Beginning with the quarter ended December 31, 2002, the escrow amount was scheduled to be reduced by $287,500 every quarter and applied to the principal portion of the term loan until the escrow amount reached zero. The Company also amended its credit agreements relative to future covenant requirements, and certain conditions were added regarding the sale of the Company's Easton facility. In November 2002, the line of credit agreement was also amended to decrease the amount available under the facility to $1,000,000. In February 2003, in accordance with the loan agreement, as amended, in connection with the sale-leaseback, the Company prepaid, without penalty, $1,387,500 of the term loan.

In June 2003 the Company amended its credit agreements relative to the term of the line of credit agreement, future covenant requirements, interest rate on the term loan, and quarterly debt repayments. Upon receiving approval from its principal bank and in accordance with its loan agreements, the Company prepaid $1,000,000 of its subordinated debt, and also utilizing cash held in escrow with its principal bank the Company prepaid $2,012,500 of its term debt with its principal bank. As of June 30, 2003, the balance of the term loan was $1,725,000, and the balance of the subordinated debt was $2,000,000. The Company is obligated to repay equal

quarterly payments of $287,500 plus accrued interest through December 31, 2004 under its term debt with its principal bank. The credit agreements were amended, reducing the interest rate on the term loan to a rate equal to the three-month LIBOR Market Index Rate plus 2.65% and also to reduce the minimum cash balance covenant to $2,000,000, and the line of credit agreement was amended to extend the expiration date of the facility to June 30, 2004.

In accordance with its loan agreements, as amended, beginning on June 30, 2003, quarterly interest payments on the subordinated debt may be made in the form of cash if the Company is in compliance with all the financial covenants set forth in the Loan Agreement, as amended, with the Company's principal bank.

(9) Stock-Based Compensation

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation -- Transition and Disclosure" ("FAS 148"), which amends SFAS No. 123, to provide alternative methods of accounting for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, FAS 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements.

The Company grants stock options for a fixed number of shares to employees and non-employee directors with an exercise price equal to the fair value of the shares at the date of grant. The Company has elected to continue to account for its stock-based compensation plans under the guidelines of

Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and, accordingly, recognizes no compensation expense on options granted to employees for the stock option grants. The Company recognizes compensation expense on options granted to non-employee directors. To date, the effect of options granted to non-employee directors has been immaterial. Additional disclosure as required under the guidelines of SFAS No. 123, "Accounting for Stock-Based Compensation" ("FAS 123"), is included below. If the Company had elected to recognize stock-based compensation expense for options granted to employees based on the fair value of granted options at the grant date (as determined under FAS 123), net earnings (in thousands) and basic and diluted earnings per share for the three and six months ended June 30, 2003 and 2002, would have been as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Net earnings, as reported	$ 617	123	1,628	466
Deduct: total stock-based employee compensation determined under fair value method, net of related tax effects	(69)	(75)	(141)	(146)
Pro forma net earnings	$ 548	48	1,487	320
Earnings per share:				
Basic-- as reported	$ .14	.03	.38	.11
Basic-- pro forma	$ .13	.01	.35	.08
Diluted-- as reported	$ .14	.03	.38	.11
Diluted-- pro forma	$ .13	.01	.34	.07

The above pro forma net earnings and basic and diluted earnings per share were computed using the fair value of granted options at the date of grant as calculated by the Black-Scholes option pricing method. No options were granted to employees during the three and six months ended June 30, 2003 and the year ended December 31, 2002.

(10) Subsequent Event

In August 2003, the Company amended its credit agreements with its principal bank to eliminate its minimum cash balance covenant, and upon receiving approval from its principal bank and in accordance with its loan agreements, the Company prepaid $500,000 of its term debt with its principal bank and $500,000 of its subordinated debt. As of the date of the prepayment, the balance of the term debt with the Company's principal bank was $1,225,000, while the balance of the subordinated debt was $1,500,000.

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 $4,501,000 at June 30, 2003 from $5,385,000 at December 31, 2002. The decrease resulted from the repayment of long-term debt of $4,975,000 and purchases of capital equipment of $145,000. Partially offsetting the decrease in cash and cash equivalents from these uses was cash provided by operating activities totaling $629,000, inclusive of a $1,000,000 cash dividend received from the SI/BAKER joint venture, proceeds of $2,734,000 from the disposition of property, plant and equipment, and a decrease of $865,000 in restricted cash during the six months ended June 30, 2003. Cash provided by operating activities during the six months ended June 30, 2002 were $1,713,000.

Acquisition of Ermanco Incorporated

On September 30, 1999, the Company acquired all of the outstanding common stock of Ermanco. 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 the 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.

In order to complete the Ermanco acquisition, the Company obtained financing from its principal bank. The Company entered into a line of credit facility which may not exceed the lesser of $1,000,000, as amended, 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 June 30, 2003, the Company did not have any borrowings under the line of credit facility, and the facility expires effective June 30, 2004. The line of credit facility is not critical to the Company's operations.

The Company financed $14,000,000 of the acquisition through a seven-year term loan from its principal 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 commenced making equal quarterly payments of $575,000 plus interest, continuing until the loan is fully repaid. In connection with an amendment entered into in November 2002, the Company prepaid, without penalty, $1,200,000 of the term loan and placed $1,150,000 in escrow with the Company's principal bank. Beginning with the quarter ended December 31, 2002, the escrow amount was scheduled to be reduced by $287,500 every quarter and applied to the principal portion of the term loan until the escrow amount reached zero. The interest rate on the term loan is variable at a rate equal to the three-month LIBOR Market Index Rate plus 2.65%, which was 3.75% as of June 30, 2003. The Company also entered into an interest rate swap agreement for a portion of the term loan to hedge the floating interest rate. At June 30, 2003, the notional amount of the seven-year interest rate swap was $3,737,500, and it fixes interest at a rate of 9.38%. As of June 30, 2003, the liability associated with the fair value of the cash flow hedge was approximately $335,000.

In February 2003, the Company sold its Easton, Pennsylvania facility. Significant terms of the agreement of sale include a sales price of $2,925,000 and also a leaseback of 25,000 square feet of office space for five years by the Company. In accordance with the loan agreement in connection with the sale, the Company prepaid, without penalty, $1,387,500 of the term loan and increased the escrow amount by $387,500.

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

Acquisition of Ermanco Incorporated (Continued)

In June 2003, the Company amended its credit agreements relative to the term of the line of credit agreement, future covenant requirements, interest rate on the term loan, and quarterly debt repayments. Upon receiving approval from its principal bank and in accordance with its loan agreements, the Company prepaid $1,000,000 of its subordinated debt, and also utilizing cash held in escrow with its principal bank the Company prepaid $2,012,500 of its term debt with its principal bank. As of June 30, 2003, the balance of the term loan was $1,725,000, and the balance of the subordinated debt was $2,000,000. The Company is obligated to repay equal quarterly payments of $287,500 plus accrued interest through December 31, 2004 under its term debt with its principal bank. The credit agreements were amended, reducing the interest rate on the term loan to a rate equal to the three-month LIBOR Market Index Rate plus 2.65%, and also to reduce the minimum cash balance covenant to $2,000,000, and the line of credit agreement was amended to extend the expiration date of the facility to June 30, 2004.

In August 2003, the Company amended its credit agreements with its principal bank to eliminate its minimum cash balance covenant, and upon receiving approval from its principal bank and in accordance with its loan agreements, the Company prepaid $500,000 of its term debt with its principal bank and $500,000 of its subordinated debt. As of the date of the prepayment, the balance of the term debt with the Company's principal bank was $1,225,000, while the balance of the subordinated debt was $1,500,000.

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 credit facility and term loan contain various restrictive covenants relating to additional indebtedness, asset acquisitions or dispositions, investments, guarantees, payment of dividends, maintenance of certain financial ratios. The Company was in compliance with all covenants as of June 30, 2003.

On September 30, 1999, the Company also issued promissory notes to fourteen stockholders of Ermanco, two of which are directors of the Company (Messrs. Shulman and Kirschner), in the original aggregate principal amount of $3,000,000. The notes have a term of seven years and bear interest at an annual rate of 10% through September 30, 2002, 12% from October 1, 2002 through September 30, 2004, and 14% from October 1, 2004 through September 30, 2006. 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 the Company's line of credit facility and term loan. From July 1, 2001 through March 31, 2003, the Company was prohibited from making any cash payments on subordinated debt and interest. However, the bank waived the restriction from paying interest on the subordinated debt in the form of cash for the fourth quarter ended December 31, 2001 and the quarter ended March 31, 2002. In accordance with its loan agreements, as amended, beginning on June 30, 2003, quarterly interest payments on the subordinated debt may be made in the form of cash if the Company is in compliance with all the financial covenants set forth in the Loan Agreement, as amended, with the Company's principal bank.

Commitments and Contingencies

Ermanco's operations are located in a 94,000 square foot steel building in Spring Lake, Michigan. The building is leased from a limited liability company that is affiliated with the Company through a common director and officer of the Company, Messrs. Shulman and Kirschner. The leasing agreement requires fixed monthly rentals of

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

Commitments and Contingencies (Continued)

$32,858 (with annual increases of 2.5%), which includes a variable portion based on the lessor's borrowing rate and the unpaid mortgage balance. The terms of the lease require the payment of all taxes, insurance, and other ownership related costs of the property. The lease expires on September 30, 2004.

In connection with the February 2003 sale of the Company's Easton, Pennsylvania facility, the Company entered into a leaseback arrangement for 25,000 square feet of office space. The leasing agreement requires fixed monthly rentals of $17,188 (with annual increases of 3%). The terms of the lease also require the payment of a proportionate share of the facility's operating expenses. The lease expires on February 21, 2008.

The Company also leases certain automobiles and office equipment, office space, computer equipment, and software under various operating leases with terms extending through September 2007.

On March 4, 1996, SI/BAKER established a $3,000,000 line of credit facility (the "Facility") with its principal bank (the "bank"). Under the terms of the Facility, SI/BAKER's parent companies, Paragon Technologies, Inc. and McKesson Automation Systems Inc., 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. The Facility was not critical to the operations of SI/BAKER; therefore, no renewal was requested and the facility and limited guarantee were cancelled effective June 30, 2003.

Other Liquidity and Capital Resource Matters

The Company anticipates that its financial resources, consisting of cash generated from operations, will be adequate to satisfy its future cash requirements through the next year. If the Company is unable to meet the terms of its financial covenants relating to its outstanding indebtedness and is unable to receive a waiver from its lender, a default could result under the Company's borrowing agreements. A default may result in the acceleration of the Company's indebtedness and cause the Company's debt to become immediately due and payable. If acceleration occurs, the Company may not be able to repay its debt, and the Company may not be able to borrow sufficient additional funds to refinance such debt. Sales volume, as well as cash liquidity, may experience fluctuations due to the unpredictability of future contract sales and the dependence upon a limited number of large contracts with a limited number of customers.

The Company plans to consider all strategic alternatives to increase shareholder value, including expansion opportunities as they arise, although the 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.

Results Of Operations

(a) Six Months Ended June 30, 2003 Versus Six Months Ended June 30, 2002

The Company's net earnings for the six months ended June 30, 2003 was $1,628,000 compared to net earnings of $466,000 for the six months ended June 30, 2002. Contributing to net earnings for the six months ended June 30, 2003 was other income from the sale-leaseback of the Company's Easton, Pennsylvania facility of $1,363,000, and a restructuring credit of $170,000 pertaining to the final settlement of the remaining pension obligations associated with the Company's terminated pension plan. Contributing to net earnings for the six months ended June 30, 2002 was other income from the short-term licensing of certain real property of $300,000, and a gain on the sale of excess fixed assets of $108,000.

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

Results Of Operations

(a) Six Months Ended June 30, 2003 Versus Six Months Ended June 30, 2002 (Continued)

Net Sales and Gross Profit on Sales

Net sales of $19,547,000 for the six months ended June 30, 2003 decreased 5.4% compared to net sales of $20,660,000 for the six months ended June 30, 2002. The sales decrease of $1,113,000 was primarily attributable to a lower volume of SI Systems' branded orders associated with the current economic slowdown and competitive pricing pressures. The decline in SI Systems' branded sales was primarily due to the prior year comparable period containing a greater amount of sales related to the Order Picking, Fulfillment, and Replenishment product line. The Company's 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 and upgrading their current production or distribution sites. The customers' timing and placement of new orders is often affected by factors such as the current economy, current interest rates, and future expectations. The Company believes that its business is not subject to seasonality, although the rate of new orders can vary substantially from month to month. Fluctuations in the Company's sales and earnings occur with increases or decreases in major installations, since the Company recognizes sales on a percentage of completion basis for its system contracts.

Gross profit, as a percentage of sales, was 26.2% for the six months ended June 30, 2003 compared to 26.0% for the six months ended June 30, 2002. Gross profit, as a percentage of sales, for the six months ended June 30, 2003 was favorably impacted by approximately 3.0% due to a reduction in overhead costs during the six months ended June 30, 2003 as compared to the six months ended June 30, 2002. Gross profit, as a percentage of sales, for the six months ended June 30, 2002 was favorably impacted by approximately 2.8% as a result of the reversal of previously established contract accruals due to changes in cost estimates.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of $3,871,000 were lower by $652,000 for the six months ended June 30, 2003 than in the six months ended June 30, 2002. The decrease of $652,000 was comprised of cost savings of approximately $650,000 attributable to a reduction of office associates in the prior fiscal year and an emphasis on cost reduction. Also contributing to the higher selling, general and administrative expenses in the six months ended June 30, 2002 were approximately $80,000 in professional fees primarily associated with enhancing operational efficiency. Partially offsetting the aforementioned favorable variance was approximately $125,000 in marketing expenses associated with the Company's participation in a biannual industry trade show in the first quarter of 2003.

Product Development Costs

Product development costs, including patent expense, of $302,000 were higher by $143,000 for the six months ended June 30, 2003 than in the six months ended June 30, 2002. Development programs in the six months ended June 30, 2003 included the new NBA-23(TM) narrow belt accumulation conveyor, computer software for warehousing and distribution center operations, and improvements to the Company's Order Picking, Fulfillment, and Replenishment product line. Development programs in the six months ended June 30, 2002 were aimed at enhancements to the Company's sortation and accumulation conveyor technologies and the Order Picking, Fulfillment, and Replenishment product line.

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

Results Of Operations

(a) Six Months Ended June 30, 2003 Versus Six Months Ended June 30, 2002 (Continued)

Restructuring Charges (Credit)

In June 2001, the Company restructured its business operations, including curtailment of a detailed benefit plan, and recorded a charge of $1,538,000 for restructuring costs. The Company received approval from the Pension Benefit Guaranty Corporation in 2002 to terminate the defined benefit plan. In December 2002, the Company partially settled its obligations by making lump-sum distributions to those participants who elected that payment option and correspondingly recorded a restructuring credit of $859,000 during the fourth quarter of 2002. In February 2003, the Company settled its remaining obligations by purchasing annuities for those participants who elected that payment option and correspondingly recorded a restructuring credit of $170,000 during the three months ended March 31, 2003.

Interest Expense and Interest Income

Interest expense of $369,000 was lower by $169,000 for the six months ended June 30, 2003 than for the six months ended June 30, 2002. The decrease in interest expense was attributable to the reduced level of long-term debt due to principal payments and lower interest rates and the reversal of approximately $50,000 of previously accrued interest on subordinated notes payable.

Interest income of $46,000 for the six months ended June 30, 2003 decreased by $7,000, when compared to the six months ended June 30, 2002. The decrease in interest income was attributable to a reduction in the level of interest rates pertaining to short-term investments.

Equity in Income of Joint Venture

Equity in income of joint venture represents the Company's proportionate share (50%) of its investment in the SI/BAKER joint venture that is being accounted for under the equity method. The favorable variance of $209,000 for the six months ended June 30, 2003 in the equity in income of the SI/BAKER joint venture was primarily due to its sales of $8,389,000 as compared to the six months ended June 30, 2002 of $4,536,000, plus a reduction of $260,000 in product development expenses. The increase in sales for the six months ended June 30, 2003 compared to the six months ended June 30, 2002 was due to a significant amount of progress made on orders received during the first half of 2003. Partially offsetting the favorable variance was SI/BAKER's increases of (1) $112,000 in selling, general and administrative expenses, and (2) $154,000 in revenue-based royalty costs due to the parent companies.

Other Income, Net

The favorable variance of $1,096,000 in other income, net for the six months ended June 30, 2003 as compared to the six months ended June 30, 2002 was primarily attributable to the gain on the sale-leaseback of the Company's Easton, Pennsylvania facility of $1,363,000, and an increase in revenue-based royalty income from the Company's SI/BAKER joint venture of $77,000. Partially offsetting the favorable variance in other income, net was the prior year comparable period containing income from the short-term licensing of certain real property relating to the Company's Easton, Pennsylvania facility of $300,000, and a gain on the sale of excess fixed assets associated with the Company's Easton, Pennsylvania facility of $108,000.

Income Tax Expense

The Company recognized income tax expense of $1,045,000 during the six months ended June 30, 2003, compared to income tax expense of $308,000 in the comparable prior year period. Income tax expense was generally recorded at statutory federal and state tax rates.

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

Results Of Operations

(a) Six Months Ended June 30, 2003 Versus Six Months Ended June 30, 2002

(Continued)

Backlog of Orders

The total backlog of orders at June 30, 2003 and 2002 was approximately $7,434,000 and $11,560,000, respectively. During the six months ended June 30, 2003 and 2002, the Company received orders totaling approximately $20,063,000 and $18,880,000, respectively.

(b) Three Months Ended June 30, 2003 Versus Three Months Ended June 30, 2002

With the exception of the following Statement of Operations captions, changes in the second quarter of calendar year 2003 compared to the prior year were consistent with those previously noted above for the six-month period:

Net Sales and Gross Profit on Sales

Net sales of $10,983,000 for the three months ended June 30, 2003 increased 10.8% compared to net sales of $9,908,000 for the three months ended June 30, 2002. The sales increase of $1,075,000 was comprised of an increase in Ermanco's sales of approximately $1,570,000 and a decrease in SI Systems' sales of approximately $495,000 for the three months ended June 30, 2003 when compared to the three months ended June 30, 2002. The improvement in Ermanco branded sales of $1,570,000 was primarily attributable to a significant amount of progress made on systems orders received during the first half of 2003. The decline of $495,000 in SI Systems' branded sales was attributable to all of its product lines.

Gross profit, as a percentage of sales, was 26.6% for the three months ended June 30, 2003 compared to 25.1% for the three months ended June 30, 2002. Gross profit, as a percentage of sales, for the three months ended June 30, 2003 was favorably impacted by approximately 4.7% due to a reduction in overhead costs during the three months ended June 30, 2003 as compared to the three months ended June 30, 2002. Gross profit, as a percentage of sales, for the three months ended June 30, 2002 was favorably impacted by approximately 3.2% as a result of the reversal of previously established contract accruals due to changes in cost estimates.

Interest Expense and Interest Income

Interest expense of $151,000 was lower by $115,000 for the three months ended June 30, 2003 than for the three months ended June 30, 2002. The decrease in interest expense was attributable to the reduced level of term debt due to principal payments, lower interest rates, and the reversal of approximately $50,000 of previously accrued interest on subordinated notes payable.

Interest income of $22,000 for the three months ended June 30, 2003 improved by $5,000, when compared to the three months ended June 30, 2002. The increase in interest income was attributable to the higher level of funds available for short-term investments.

Other Income, Net

The unfavorable variance of $79,000 in other income, net for the three months ended June 30, 2003 as compared to the three months ended June 30, 2002 was primarily attributable to the prior year comparable period containing income from the short-term licensing of certain real property of the Company's Easton, Pennsylvania facility of approximately $150,000. Partially offsetting the unfavorable variance in other income, net was an increase of $93,000 in revenue-based royalty income from the Company's SI/BAKER joint venture and license agreements related to material handling system sales.

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

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) the results of pending litigation related to the Company's intellectual property; or (5) if the factors on which the Company's conclusions are based do not conform to the Company's expectations.

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 has available 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 50% of its new term loan from its principal bank to effectively convert half 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.

Item 4. Controls and Procedures

(a) An evaluation was performed under the supervision and with the participation of the Company's management, including its Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, of the effectiveness of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of June 30, 2003. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported as specified in Securities and Exchange Commission rules and forms.

(b) There were no significant changes in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II -- OTHER INFORMATION

Item 1. Legal Proceedings

On July 10, 2003, a competitor filed an action against the Company in the United States District Court for the District of New Jersey alleging, among other things, that certain of the Company's products infringe patents held by the competitor and breach of contract, wrongful use, and unlawful misappropriation of the competitor's trade secrets, technology and other proprietary information and unlawful claim of ownership of the competitor's inventions and technology related to certain of the competitor's products. Based on these allegations, the competitor is seeking monetary damages and injunctive relief against the Company.

The Company denies the material allegations of the complaint and is considering asserting counterclaims against the competitor. Discovery has not yet commenced, and the matter has not yet been set for trial. Management of the Company, supported by its legal counsel, believes the competitor's complaint is without merit and has instructed counsel to defend vigorously against all charges.

The Company is presently engaged in certain other legal proceedings, which, on the basis of information furnished by counsel and others, the Company believes present no significant risk of material loss to the Company.

Item 4. Submission of Matter to a Vote of Security Holders

The Company's Annual Meeting of Stockholders was held on June 11, 2003 with the following item being submitted to a vote of stockholders:

1. The election of eight directors to the Board of Directors.

Details of the proposal noted above was provided to stockholders in the form of a Notice of Annual Meeting and Proxy Statement mailed on May 19, 2003, with such solicitation being in accordance with Regulation 14 of the Securities and Exchange Act of 1934.

There was no solicitation in opposition to the management's nominees listed in the Proxy Statement, and all the management's nominees were elected.

The voting results on the election of directors are set forth as follows:

1. Election of Directors:

Name of Nominee	Votes For	Votes Withheld	Non-Voting
L. Jack Bradt	3,450,455	388,213	427,709
Gilman J. Hallenbeck	3,747,392	91,276	427,709
William R. Johnson	3,466,455	372,213	427,709
Leon C. Kirschner	3,508,355	330,313	427,709
Theodore W. Myers	3,799,792	38,876	427,709
Anthony W. Schweiger	3,799,692	38,976	427,709
Steven Shulman	3,747,392	91,276	427,709
Leonard S. Yurkovic	3,560,990	277,678	427,709

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

10.32 Eighth Amendment to Line of Credit Note and Loan Agreement (Line of Credit) dated June 5, 2003 (filed herewith).

10.33 Loan Agreement (Term Loan A and Term Loan B) entered into June 5, 2003 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (filed herewith).

10.34 Promissory Note related to Term Loan A entered into June 5, 2003 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (filed herewith).

10.35 Promissory Note related to Term Loan B entered into June 5, 2003 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (filed herewith).

10.36 Security Agreement related to Term Loan A dated

June 5, 2003 by and between Paragon Technologies, Inc. and Wachovia Bank, National Association (filed herewith).

31.1 Certification by Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed by William R. Johnson, President and CEO (filed herewith).

31.2 Certification by Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 signed by Ronald J. Semanick, Chief Financial Officer and Vice President - Finance and Treasurer (filed herewith).

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by William R. Johnson, President and CEO, and Ronald J. Semanick, Chief Financial Officer and Vice President - Finance and Treasurer (filed herewith).

(b) The following report on Form 8-K was filed during the quarter ended June 30, 2003:

A Form 8-K was filed on May 14, 2003 regarding the Press Release dated May 14, 2003 announcing financial results for the first quarter ended March 31, 2003.

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

William R. Johnson
President & CEO

/s/ Ronald J. Semanick

Ronald J. Semanick
Chief Financial Officer

Dated: August 14, 2003