PARAGON TECHNOLOGIES INC
Form 10-Q
November 12, 2004

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, 2004

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 November 5, 2004: 4,260,360.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Paragon Technologies, Inc. and Subsidiary
Consolidated Balance Sheets
September 30, 2004 and December 31, 2003
(In Thousands, Except Share Data)

	(UNAUDITED) September 30, 2004	December 31 2003
Assets		
Current assets:		
Cash and cash equivalents.....................	$ 3,733	5,591
Receivables:		
Trade (net of allowance for doubtful accounts of $216 as of September 30, 2004 and $265 as of December 31, 2003)................................	7,140	5,277
Notes and other receivables..................	236	38
Total receivables..........................	7,376	5,315
Costs and estimated earnings in excess of billings................................	258	521
Inventories:		
Raw materials...............................	1,332	926
Work-in-process.............................	226	106
Finished goods..............................	261	159
Total inventories..........................	1,819	1,191
Deferred income tax benefits...................	772	1,444
Prepaid expenses and other current assets.......	727	629
Total current assets.......................	14,685	14,691
Property, plant and equipment, at cost:		

Leasehold improvements.........................	228	228
Machinery and equipment........................	3,856	3,643
	------	------
	4,084	3,871
Less: accumulated depreciation................	2,781	2,455
	------	------
Net property, plant and equipment............	1,303	1,416
	------	------
Goodwill..	17,657	17,657
Other assets....................................	10	10
	------	------
Total assets....................................	$ 33,655	33,774
	======	======

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, 2004 and December 31, 2003
(In Thousands, Except Share Data)

	(UNAUDITED) September 30, 2004	December 31 2003
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable...............................	$ 3,389	2,671
Customers' deposits and billings in excess of costs and estimated earnings	2,426	2,180
Accrued salaries, wages, and commissions................................	455	304
Income taxes payable..........................	-	894
Accrued product warranty.......................	766	925
Deferred gain on sale-leaseback................	165	165
Accrued other liabilities......................	1,280	2,507
	------	------
Total current liabilities..................	8,481	9,646
	------	------

Long-term liabilities:		
Deferred gain on sale-leaseback.................	399	523
Deferred income taxes payable..................	1,967	1,594
Deferred compensation..........................	47	42
Total long-term liabilities................	2,413	2,159
Commitments and contingencies		
Stockholders' equity:		
Common stock, $1 par value; authorized 20,000,000 shares; issued and outstanding 4,276,060 shares as of September 30, 2004 and 4,277,595 shares as of December 31, 2003.............	4,276	4,278
Additional paid-in capital.....................	7,876	7,586
Retained earnings..............................	10,609	10,105
Total stockholders' equity.................	22,761	21,969
Total liabilities and stockholders' equity..	$ 33,655	33,774

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 Nine Months Ended September 30, 2004 and 2003
(In Thousands, Except Share And Per Share Data)

	Three Months Ended		Nine Months Ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
Net sales................	$ 10,754	8,742	30,968	28,289
Cost of sales............	7,738	6,508	22,988	20,927
Gross profit on sales.....	3,016	2,234	7,980	7,362
Selling, general and administrative expenses..............	2,228	2,992	6,345	6,863

Product development costs..................	69	60	274	363
Restructuring charges (credit)...............	-	-	-	(170)
Interest expense..........	-	306	-	675
Interest income...........	(10)	(9)	(61)	(55)
Equity in income of joint venture..........	-	(5)	-	(256)
Gain on sale of SI/BAKER joint venture................	-	(4,919)	-	(4,919)
Gain on disposition of property, plant and equipment..........	-	-	-	(1,361)
Other income, net.........	(46)	(103)	(145)	(364)
	2,241	(1,678)	6,413	776
Earnings before income taxes...........	775	3,912	1,567	6,586
Income tax expense........	310	1,500	632	2,545
Net earnings..............	$ 465	2,412	935	4,041
Basic earnings per share..............	$ .11	.56	.22	.95
Diluted earnings per share..............	$ .11	.55	.21	.93
Weighted average shares outstanding.....	4,290,310	4,277,345	4,282,681	4,266,778
Dilutive effect of stock options..........	63,710	133,799	77,672	98,206
Weighted average shares outstanding assuming dilution......	4,354,020	4,411,144	4,360,353	4,364,984

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 Nine Months Ended September 30, 2004 and 2003
(In Thousands)

	Three Months Ended		Nine Months Ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
Net earnings................	$ 465	2,412	935	4,041
Other comprehensive income (loss), net of tax:				
Interest rate swap:				
Change in fair value of derivative, net of tax.................	-	-	-	(8)
Total other comprehensive income (loss).......	-	-	-	(8)
Comprehensive income..........	$ 465	2,412	935	4,033

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, 2004 and 2003
(In Thousands, Except Share Data)

	Nine Months Ended	
	September 30, 2004	September 30, 2003
Cash flows from operating activities:		
Net earnings	$ 935	4,041
Adjustments to reconcile net earnings to net cash provided (used) by operating activities:		
Depreciation of plant and equipment............	326	415
Amortization of intangibles....................	-	57
Gain on disposition of property, plant and equipment..........................	-	(1,361)

Gain on sale of SI/BAKER joint venture..........	-	(4,919)
Amortization of deferred gain on sale-leaseback....................................	(124)	(96)
Cash dividend received from joint venture.......	-	1,000
Equity in income of joint venture...............	-	(256)
Noncash interest charges associated with settlement of interest rate swap contract................................	-	188
Issuance of common shares as interest payment on subordinated notes.................	-	90
Change in operating assets and liabilities:		
Receivables................................	(2,061)	586
Costs and estimated earnings in excess of billings......................	263	(145)
Inventories................................	(628)	302
Deferred tax expenses......................	1,045	259
Prepaid expenses and other current assets..........................	(98)	(31)
Other noncurrent assets....................	-	1
Accounts payable...........................	718	355
Customers' deposits and billings in excess of costs and estimated earnings................................	246	(844)
Accrued salaries, wages, and commissions.............................	151	(81)
Income taxes payable.......................	(894)	1,595
Accrued product warranty...................	(159)	25
Accrued other liabilities..................	(1,227)	621
Deferred compensation......................	5	10
Net cash provided (used) by operating activities.............................	(1,502)	1,812
Cash flows from investing activities:		
Proceeds from the disposition of property, plant and equipment	-	2,734
Proceeds from the divestment of the SI/BAKER joint venture, net of advisory fees..............	-	5,500
Additions to property, plant and equipment..........	(213)	(180)
Net cash provided (used) by investing activities.............................	(213)	8,054

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 Nine Months Ended September 30, 2004 and 2003
(In Thousands, Except Share Data)

	Nine Months Ended	
	September 30, 2004	September 30, 2003
Cash flows from financing activities:		
Sale of common shares in connection with employee incentive stock option plan	38	12
Repurchase and retirement of common stock	(181)	-
Decrease in restricted cash	-	865
Repayment of long-term debt	-	(8,700)
Settlement of interest rate swap contract	-	(283)
Net cash provided (used) by financing activities	(143)	(8,106)
Increase (decrease) in cash and cash equivalents	(1,858)	1,760
Cash and cash equivalents, beginning of period	5,591	5,385
Cash and cash equivalents, end of period	$ 3,733	7,145
Supplemental disclosures of cash flow information:		
Cash paid (received) during the period for:		
Interest	$ -	456
Income taxes	$ 616	(118)
Supplemental disclosures of noncash financing activities:		
Equity impact from exercise of non-qualified stock options	$ -	40
Withholding of common shares for income tax withholding obligations arising from exercise of non-qualified stock options	$ -	(31)

See accompanying notes to consolidated financial statements.

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Item 1. Financial Statements (Continued)

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Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements (Unaudited)
For the Three and Nine Months Ended September 30, 2004 and 2003

(1) In the opinion of the management of Paragon Technologies, Inc. ("Paragon" or the "Company"), the unaudited 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 full 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, 2003 as filed with the Securities and Exchange Commission. Refer to the Company's Form 10-K for the year ended December 31, 2003 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. 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 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 2003.

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

	Beginning Balance January 1	Charge/ (Credit)	Cash Spending	Reclassification	Ending Balance September 30
2004............	$ 68	-	(5)	-	63
2003............	$ 216	(170)	(48)	170	168

The $63,000 restructuring accrual at September 30, 2004 relates to professional fees for the 2001 restructuring that are still expected to be paid and is included in accrued other liabilities.

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

(3) Accrued Product Warranty

The Company's products are warranted against defects in materials and workmanship for varying periods of time depending on customer requirements and the type of system sold, with a typical warranty period of one year. The Company provides an accrual for estimated future warranty costs and potential product liability claims based upon a percentage of cost of sales, ranging from one to two percent depending on the type of system sold, and a detailed review of products still in the warranty period.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements (Unaudited)
For the Three and Nine Months Ended September 30, 2004 and 2003

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

	Beginning Balance January 1	Additions	Deductions	Ending Balance September 30
2004..................	$ 925	70	(229)	766
2003..................	$ 894	159	(134)	919

(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 operation (hereafter referred to as "SI Systems") is a specialized systems integrator supplying branded automated material handling systems to manufacturing, assembly, order selection, and distribution operations customers located primarily in North America, including the U.S. government. The automated material handling systems are marketed, designed, sold, installed, and serviced by its own staff or subcontractors as labor-saving devices to improve productivity, quality, and reduce costs. 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. The engineering staff develops and designs computer control programs required for the efficient operation of the systems and for optimizing manufacturing, assembly, and fulfillment operations.

Ermanco

The Company's Spring Lake, Michigan operation (hereafter referred to as "Ermanco") is a manufacturer of Ermanco branded light to medium duty unit handling conveyor 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 nine months ended September 30, 2004 and 2003 are as follows (in thousands):

For the three months ended September 30, 2004:

	SI Systems	Ermanco	Total	% of Total Sales
Systems sales	$ 2,191	7,103	9,294	86.4%
Aftermarket sales	920	540	1,460	13.6%
Total sales	$ 3,111	7,643	10,754	100.0%
As a % of total sales	28.9%	71.1%	100.0%	

For the three months ended September 30, 2003:

	SI Systems	Ermanco	Total	% of Total Sales
Systems sales	$ 2,112	5,519	7,631	87.3%
Aftermarket sales	697	414	1,111	12.7%
Total sales	$ 2,809	5,933	8,742	100.0%
As a % of total sales	32.1%	67.9%	100.0%	

For the nine months ended September 30, 2004:

	SI Systems	Ermanco	Total	% of Total Sales
Systems sales.................	$ 6,020	20,891	26,911	86.9%
Aftermarket sales.............	2,500	1,557	4,057	13.1%
Total sales...................	$ 8,520	22,448	30,968	100.0%
As a % of total sales.........	27.5%	72.5%	100.0%	

For the nine months ended September 30, 2003:

	SI Systems	Ermanco	Total	% of Total Sales
Systems sales.................	$ 6,989	17,844	24,833	87.8%
Aftermarket sales.............	2,219	1,237	3,456	12.2%
Total sales...................	$ 9,208	19,081	28,289	100.0%
As a % of total sales.........	32.5%	67.5%	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 nine months ended September 30, 2004 and 2003 are as follows (in thousands):

For the three months ended September 30, 2004:

	SI Systems	Ermanco	Total	% of Total Sales
Domestic sales................	$ 2,852	7,370	10,222	95.1%
International sales...........	259	273	532	4.9%
Total sales...................	$ 3,111	7,643	10,754	100.0%

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements (Unaudited)
For the Three and Nine Months Ended September 30, 2004 and 2003

For the three months ended September 30, 2003:

	SI Systems	Ermanco	Total	% of Total Sales
Domestic sales................	$ 2,231	5,698	7,929	90.7%
International sales...........	578	235	813	9.3%
Total sales..................	$ 2,809	5,933	8,742	100.0%

For the nine months ended September 30, 2004:

	SI Systems	Ermanco	Total	% of Total Sales
Domestic sales................	$ 7,282	21,912	29,194	94.3%
International sales...........	1,238	536	1,774	5.7%
Total sales..................	$ 8,520	22,448	30,968	100.0%

For the nine months ended September 30, 2003:

	SI Systems	Ermanco	Total	% of Total Sales
Domestic sales................	$ 8,076	17,933	26,009	91.9%
International sales...........	1,132	1,148	2,280	8.1%
Total sales..................	$ 9,208	19,081	28,289	100.0%

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

For the Three Months Ended September 30, 2004 (In Thousands):	SI Systems	Ermanco	Total
Sales....................................	$ 3,111	7,643	10,754
Earnings (loss) before interest expense, interest income, and income taxes...........................	74	691	765
Total assets.............................	5,764	27,891	33,655
Capital expenditures.....................	4	59	63
Depreciation and amortization expense................................	26	86	112

For the Three Months Ended

September 30, 2003 (In Thousands):	SI Systems	Ermanco	Total
Sales....................................	$ 2,809	5,933	8,742
Earnings before interest expense, interest income, equity in income of joint venture, gain on sale of SI/BAKER joint venture, gain on disposition of property, plant and equipment, and income taxes...........................	54	(769)	(715
Gain on sale of SI/BAKER joint venture................................	4,919	-	4,919
Gain on disposition of property, plant and equipment....................	-	-	-
Total assets.............................	6,487	27,741	34,228
Capital expenditures.....................	4	31	35
Depreciation and amortization expense................................	32	100	132

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Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements (Unaudited)
For the Three and Nine Months Ended September 30, 2004 and 2003

For the Nine Months Ended September 30, 2004 (In Thousands):	SI Systems	Ermanco	Total
Sales....................................	$ 8,520	22,448	30,968
Earnings (loss) before interest expense, interest income, and income taxes...........................	(159)	1,665	1,506
Total assets.............................	5,764	27,891	33,655
Capital expenditures.....................	56	157	213
Depreciation and amortization expense................................	79	247	326

For the Nine Months Ended September 30, 2003 (In Thousands):	SI Systems	Ermanco	Total
Sales....................................	$ 9,208	19,081	28,289
Earnings before interest expense, interest income, restructuring credits, equity in income of joint venture, gain on sale of SI/BAKER joint venture, gain (loss) on disposition of property, plant and equipment, and income taxes.........	290	210	500
Restructuring credits....................	170	-	170

Gain on sale of SI/BAKER joint venture	4,919	-	4,919
Gain (loss) on disposition of property, plant and equipment	1,363	(2)	1,361
Total assets	6,487	27,741	34,228
Capital expenditures	38	142	180
Depreciation and amortization expense	114	301	415

(5) Recently Issued Accounting Pronouncements

In December 2003, the Company adopted SFAS No. 132 (revised), "Employers' Disclosures about Pensions and Other Postretirement Benefits" ("FAS 132") as amended. This standard retains the existing disclosures and requires additional disclosures to provide details about pension plan assets, benefit obligations, cash flows, benefit costs, and related information. The disclosure requirements are included in the Company's financial statements.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements (Unaudited)
For the Three and Nine Months Ended September 30, 2004 and 2003

(6) Sale-Leaseback

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 for five years. The leasing agreement requires fixed monthly rentals of $17,703 (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 sale-leaseback resulted in a gain of $2,189,000, of which $1,363,000 was recorded as a gain during the three months ended March 31, 2003. The remaining gain of $826,000 was deferred and is being recognized as a reduction in rent expense over the term of the lease. During the three months ended September 30, 2004 and September 30, 2003, $41,000 and $40,000, respectively, of the deferred gain was recognized. During the nine months ended September 30, 2004 and September 30, 2003, $124,000 and $96,000, respectively, of the deferred gain was recognized.

(7) Investment in SI/BAKER Joint Venture

On March 1, 1993, the Company and Automated Prescription Systems, Inc. formed a 50/50 joint venture, SI/BAKER, INC. ("SI/BAKER"). In 1998, Automated Prescription Systems, Inc. was renamed McKesson Automation Systems Inc. ("McKesson"). On September 19, 2003, the Company sold its entire ownership interest in SI/BAKER to McKesson and received cash proceeds of $5,600,000. Prior to the sale, the Company received royalty income from SI/BAKER at a rate of 2% of SI/BAKER's gross sales for marketing and sales efforts on behalf of SI/BAKER. The Company accounted for its investment in the joint venture on the equity basis by recognizing its proportionate share (50%) of SI/BAKER's net earnings. The sale resulted in a gain of $4,901,000 in 2003.

(8) Line of Credit

The Company has a line of credit facility which may not exceed $5,000,000, $4,800,000 is available, and is to be used primarily for working capital purposes. Interest on the line of credit facility is at the LIBOR Market Index Rate plus 1.4%.

The line of credit facility contains various non-financial covenants and is secured by all accounts receivables and inventory. The Company was in compliance with all covenants as of September 30, 2004. As of September 30, 2004, the Company did not have any borrowings under the line of credit facility, and the line of credit facility expires effective June 30, 2005.

(9) Long-Term Debt

The Company received $14,000,000 in the form of a seven-year term loan from its principal bank to finance the acquisition of Ermanco on September 30, 1999. The interest rate on the term loan was variable at a rate equal to the three-month LIBOR Market Index Rate plus 2.65%.

Also in connection with the acquisition of Ermanco, on September 30, 1999, the Company issued promissory notes to the stockholders of Ermanco, including notes in the amounts of $1,382,861 and $1,001,382 to Steven Shulman and Leon C. Kirschner, respectively. Mr. Shulman is a director of the Company, and Mr. Kirschner serves as the President of Ermanco and Chief Operating Officer of the Company. The notes, with an original term of seven years, bore interest at an annual rate of 10% through September 30, 2002, and 12% from October 1, 2002 through the prepayment date. Interest on the promissory notes was payable quarterly, in cash or under certain conditions, in the Company's common stock upon approval of the Company's Board of Directors.

In 2003, the Company prepaid all of its outstanding term and subordinated debt.

(10) Pension Benefits

The Company maintains a defined benefit plan for employees covered by its collective bargaining agreement. Retirement benefits are based on the employee's years of service multiplied by the appropriate monthly benefit amount. Employee compensation does not impact pension benefits. The Company's policy is to fund retirement plans in compliance with applicable laws and regulations. Assets of the Company's defined benefit plan are primarily invested in publicly traded common stocks, corporate and government debt securities, mutual funds, and cash or cash equivalents.

Components of Net Periodic Pension Expense (Benefit)

The Company uses the projected unit credit actuarial method to compute pension expense, which includes amortization of past service costs over 30 years. The net periodic pension expense (benefit) and total pension expense (benefit) for the three and nine months ended September 30, 2004 and 2003 includes the following components (in thousands):

	Three Months Ended		Nine
	September 30, 2004	September 30, 2003	September 2004
Service cost-benefits earned during the period.....	$ 23	22	70
Interest cost on projected benefit obligation..........	11	10	33
Expected return on plan assets - increase...........	(15)	(13)	(44)
Recognized net actuarial loss (gain)................	1	1	3
Net periodic pension expense.....................	20	20	62
Curtailment cost (settlement credit).........	-	-	-
Total pension expense (benefit)..................	$ 20	20	62

Contributions

The Company made $45,000 of contributions to its defined benefit plan during the three and nine months ended September 30, 2004. The Company expects total pension plan contributions to its defined benefit plan to approximate $90,000 for the year ended December 31, 2004.

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary

Notes To Consolidated Financial Statements (Unaudited)
For the Three and Nine Months Ended September 30, 2004 and 2003

(11) Stock Repurchase Program

In August 2004, the Company's Board of Directors approved a program to repurchase up to $1,000,000 of its outstanding common stock. As of September 30, 2004, the Company had repurchased 19,000 shares of common stock at a weighted average cost, including brokerage commissions, of $9.55 per share. Cash expenditures for the stock repurchases approximated $181,424. As of September 30, 2004, approximately $818,576 remained available for repurchases under the stock repurchase program. Based on market conditions and other factors, additional repurchases may be made from time to time, in compliance with SEC regulations, in the open market or through privately negotiated transactions at the discretion of the Company. There is no expiration date with regards to the stock repurchase program.

(12) Stock-Based Compensation

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"), as amended by FAS 148, 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 nine months ended September 30, 2004 and 2003, would have been as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2004	September 30, 2003	September 30, 2004	Septem 20
Net earnings, as reported.................	$ 465	2,412	935	4,
Deduct: total stock-based employee compensation determined under fair value method, net of related tax effects..................	(29)	(56)	(92)	(
Pro forma net earnings.................	$ 436	2,356	843	3,

Earnings per share:			
Basic - as reported......	$ .11	.56	.22
Basic - pro forma........	$ .10	.55	.20
Diluted - as reported....	$ .11	.55	.21
Diluted - pro forma......	$ .10	.53	.19

Item 1. Financial Statements (Continued)

Paragon Technologies, Inc. and Subsidiary
Notes To Consolidated Financial Statements (Unaudited)
For the Three and Nine Months Ended September 30, 2004 and 2003

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 nine months ended September 30, 2004 and the year ended December 31, 2003.

(13) Legal Proceedings

In July 2003, a competitor filed an action against the Company in the United States District Court for the District of New Jersey alleging that certain of the Company's products infringed patents held by the competitor and also asserting claims for breach of contract, unjust enrichment, unfair competition, tortious interference with prospective economic advantage, and violation of New Jersey's consumer fraud act as a result of alleged improper use of the competitor's trade secrets, technology, and other proprietary information. Based on these allegations, the competitor was seeking monetary damages and injunctive relief against the Company.

In February 2004, a settlement was reached between the Company and the competitor. Under the settlement, the competitor dismissed the action and agreed that the Company's products involved in the litigation are immune from suit for infringement of any of the competitor's intellectual property rights. In exchange, Paragon agreed to dismiss its counterclaims and paid the competitor $1,125,000. Total costs associated with the litigation recognized during 2003, inclusive of settlement costs and legal costs, were $1,375,000.

The Company is involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

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

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with the unaudited consolidated financial statements for the period ended September 30, 2004, and the cautionary statements and consolidated financial statements and related notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003. The discussion and analysis contains "forward-looking statements" based on management's current expectations, assumptions, estimates, and projections. These forward-looking statements involve risks and uncertainties. The Company's actual results could differ materially from those included in these "forward-looking statements" as a result of risks and uncertainties, identified in connection with those forward-looking statements, including those factors identified herein, and in the Company's other publicly filed reports.

Business Overview

Paragon Technologies, Inc. provides a variety of material handling solutions, including systems, technologies, products, and services for material flow applications. The Company has gone to market with a multiple brand, multiple channel strategy under the SI Systems and Ermanco brands.

Founded in 1958, SI Systems material handling solutions are based on core technologies in horizontal transportation and order fulfillment and are aimed at improving productivity for manufacturing, assembly, and distribution center operations. Since 1964, Ermanco conveyor technologies and integrated conveyor systems have been based on core technologies in transportation, accumulation, and sortation and continue to address the needs of the distribution, assembly, and manufacturing marketplace. Ermanco is known as the originator of the line-shaft-driven, live-roller conveyor.

Key Performance Metrics Relevant to the Company

Capacity Utilization

Capacity Utilization, as documented in the Federal Reserve Statistical Release(1), is a key economic indicator that the Company follows as a barometer that may lead to capital spending for material handling systems. Capacity Utilization attempts to measure what percent of available capacity is actually being utilized. Management believes that when Capacity Utilization rises above 80%, as occurred in fiscal 2000, the Company may see an increase in rate of new orders, and therefore, an increase in backlog and sales may also occur. The backlog of orders represents the uncompleted portion of systems contracts along with the value of parts and services from customer purchase orders related to goods that have not been shipped or services that have not been rendered. Backlog is generally indicative of customer demand for the Company's products. As the demand for the Company's products increases, the backlog of orders, rate of new orders, and sales also typically increases. The following table depicts the Company's backlog, orders, sales, and Capacity Utilization for the nine months ended September 30, 2004, and for the years ended December 31, 2003, 2002, 2001, and 2000.

	Nine Months Ended September 30,	Year Ended December 31,			
(Dollars in Thousands)	2004	2003	2002	2001	2000
Backlog of orders - Beginning............	$ 10,525	6,924	13,342	22,913	23,68
Add: orders..........................	32,343	40,896	31,806	41,181	63,53
Less: sales..........................	30,968	37,295	38,224	50,752	64,30
Backlog of orders - Ending..............	$ 11,900	10,525	6,924	13,342	22,91
Capacity Utilization(1).................	76.8%	74.8%	75.6%	77.7%	82.6

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

Current Ratio

The Company's current ratio, which is the ratio of current assets to current liabilities, has been relatively consistent. Management of the Company monitors the current ratio as a measure of determining liquidity and believes the current ratio illustrates that the Company's financial resources are adequate to satisfy its future cash requirements through the next year. The following table depicts the Company's current assets, current liabilities, and current ratio as of September 30, 2004 and as of December 31, 2003, 2002, 2001, and 2000:

	As of	As of December 31,

(Dollars in Thousands)	September 30, 2004	2003	2002	2001	2000
Current assets...........................	$ 14,685	14,691	15,444	19,200	22,85
Current liabilities.....................	8,481	9,646	9,472	13,388	15,19
Current ratio...........................	1.73	1.52	1.63	1.43	1.5

Debt to Equity Ratio

With an emphasis over the past several years on generating cash flows to eliminate the Company's senior and subordinated debt, the Company has eliminated its financial leverage as evidenced by its debt to equity ratio, which is the ratio of total debt to stockholders' equity. Management believes the absence of debt provides greater protection for its shareholders and enhances the Company's ability to obtain additional financing, if required. The following table illustrates the calculation of the debt to equity ratio as of September 30, 2004, and as of December 31, 2003, 2002, 2001, and 2000:

(Dollars in Thousands)	As of September 30, 2004	As of December 31, 2003	2002	2001	2000
Current installments of long-term debt.......................	$ -	-	1,437	2,305	1,52
Long-term debt..........................	-	-	7,263	9,900	12,78
Total debt..............................	-	-	8,700	12,205	14,30
Total stockholders' equity............	$ 22,761	21,969	17,829	16,881	16,98
Debt to equity ratio....................	-	-	.49	.72	.8

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with United States Generally Accepted Accounting Principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and other financial information, including the related disclosure of commitments and contingencies at the date of our financial statements. Actual results may, under different assumptions and conditions, differ significantly from our estimates.

We believe that our accounting policies related to revenue recognition on system sales, warranty, inventories, allowance for doubtful accounts, and asset impairments as described below, are our "critical accounting policies." These policies have been reviewed with the Audit Committee of the Board of Directors and are discussed in greater detail below.

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

Revenue Recognition on Systems Sales

Revenues on systems contracts, accounted for in accordance with SOP 81-1 of the American Institute of Certified Public Accountants, are recorded on the basis of the Company's estimates of the percentage of completion of individual contracts. Gross margin is recognized on the basis of the ratio of aggregate costs incurred to date to the most recent estimate of total costs. As contracts may extend over one or more years, revisions in cost and profit estimates during the course of the work are reflected in the accounting periods in which the facts requiring revisions become known. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is accrued. As of September 30, 2004, there were no contracts that are anticipated to result in a loss.

The Company believes that it has the ability to reasonably estimate the total costs and applicable gross profit margins at the inception of the contract for all of its systems contracts. However, where cost estimates change, there could be a significant impact on the amount of revenue recognized. The Company's failure to estimate accurately can result in cost overruns which will result in the loss of profits if the Company determines that it has significantly underestimated the costs involved in completing contracts. The Company has not had any significant cost overruns resulting in loss of profits during the three and nine months ended September 30, 2004.

Accrued Product Warranty

The Company's products are warranted against defects in materials and workmanship for varying periods of time depending on customer requirements and the type of system sold, with a typical warranty period of one year. The Company provides an accrual for estimated future warranty costs and potential product liability claims based upon a percentage of cost of sales, ranging from one to two percent depending on the type of system sold, and a detailed review of products still in the warranty period. Historically, the level of warranty reserve has been appropriate based on management's assessment of estimated future warranty claims. However, if unanticipated warranty issues arise in the future, there could be a significant impact on the recorded warranty reserve. The recorded warranty reserve as of September 30, 2004 was $766,000.

Inventories

Inventories are valued at the lower of average cost or market. The Company provides an inventory reserve determined by a specific identification of individual slow moving items and other inventory items based on historical experience. The reserve is considered to be a write-down of inventory to a new cost basis. Upon disposal of inventory, the cost and related inventory reserve are removed from the accounts. Historically, the level of inventory reserve has been appropriate based on management's assessment of estimated future inventory disposals.

Allowance for Doubtful Accounts

The Company provides an allowance for doubtful accounts determined by a specific identification of individual accounts and other accounts based on historical experience. The Company writes off receivables upon determination that no further collections are probable. Historically, receivable write offs have not had a material impact on the Company's financial statements.

Asset Impairments

On January 1, 2002, the Company adopted SFAS No. 142, analyzed its goodwill for impairment, and makes similar evaluations on a periodic basis. During 2003, the Company performed the required impairment test of goodwill and determined that there was no impairment. In assessing the recoverability of the Company's goodwill, the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective asset. If these estimates or their

Asset Impairments (Continued)

related assumptions change the fair value of the asset in the future, the Company may be required to record impairment charges. The book value of goodwill as of September 30, 2004 was $17,657,000.

(a) Results of Operations -- Nine Months Ended September 30, 2004 Compared to the Nine Months Ended September 30, 2003

Earnings Summary

The Company had net earnings of $935,000 (or $0.22 basic earnings per share) for the nine months ended September 30, 2004, compared to net earnings of $4,041,000 (or $0.95 basic earnings per share) for the nine months ended September 30, 2003. The decrease in net earnings was primarily due to the prior year comparable period containing:

- a pre-tax gain on the sale of the Company's ownership interest in the SI/BAKER joint venture of $4,919,000;
- a pre-tax gain on the sale-leaseback of the Company's Easton, Pennsylvania facility of $1,363,000;
- a restructuring credit of $170,000 pertaining to the final settlement of the remaining pension obligations associated with the Company's terminated pension plan;
- equity in income of the Company's former SI/BAKER joint venture of $256,000; and
- royalty income from the Company's former SI/BAKER joint venture of $226,000.

Partially offsetting the above decrease in net earnings for the nine months ended September 30, 2004 was a reduction of (1) $675,000 in interest expense as a result of the elimination of the Company's senior and subordinated debt in September 2003, and (2) the prior year comparable period containing an accrual of $1,020,000 associated with potential defense costs to defend charges asserted against the Company by a competitor relating to the Company's intellectual property.

Net Sales and Gross Profit on Sales

	2004	2003
Net sales	$30,968,000	28,289,000
Cost of sales	22,988,000	20,927,000
Gross profit on sales	$ 7,980,000	7,362,000
Gross profit as a percentage of sales	25.8%	26.0%

The net sales increase was primarily attributable to an increase in Ermanco branded sales of $3,367,000, partially offset by a decline of approximately $688,000 in SI Systems branded sales. The increase in Ermanco branded sales was primarily attributable to a larger backlog of Ermanco branded orders entering fiscal 2004 when compared to the backlog of Ermanco branded orders entering fiscal 2003. The decline in SI Systems branded sales was associated with delays in customer buying decisions and competitive pressures.

Gross profit, as a percentage of sales, for the nine months ended September 30, 2004, when compared to the nine months ended September 30, 2003, was favorably impacted by approximately 0.4% due to product mix, and unfavorably impacted by approximately 0.6% due primarily to costs related to enhancing the Company's operations.

(a) Results of Operations -- Nine Months Ended September 30, 2004 Compared to the Nine Months Ended September 30, 2003 (Continued)

Selling, General and Administrative Expenses

Selling, general and administrative expenses of $6,345,000 were lower by $518,000 for the nine months ended September 30, 2004 than for the nine months ended September 30, 2003. The decrease was attributable to the prior year comparable period being impacted by the accrual of $1,020,000 associated with potential defense costs to defend charges asserted against the Company by a competitor relating to the Company's intellectual property that was settled in 2004 and collections of $172,000 during the second quarter of 2004 on accounts receivable previously recognized as uncollectible. Partially offsetting these decreases were the addition of resources aimed at expanding the customer base and an increase in salaries and fringe benefits totaling $377,000, an increase in consulting and marketing expenses primarily associated with product promotion and marketing research totaling $184,000, and severance costs of $115,000.

Product Development Costs

Product development costs, including patent expense, of $274,000 was lower by $89,000 for the nine months ended September 30, 2004 than for the nine months ended September 30, 2003. Development programs in the nine months ended September 30, 2004 were aimed at enhancements to the Company's sortation and accumulation conveyor technologies, and improvements to the Company's Order Picking, Fulfillment, and Replenishment systems. Development programs in the nine months ended September 30, 2003 included the new NBA-23(TM) narrow belt accumulation conveyor, computer software for warehousing and distribution center operations, and improvements to the narrow belt sorter and the Company's Order Picking, Fulfillment, and Replenishment systems.

Restructuring Charges (Credits)

In 2001, the Company restructured its business operations, including curtailment of a defined benefit plan. In February 2003, the Company settled its remaining pension obligations by purchasing annuities and correspondingly recorded a restructuring credit of $170,000.

Interest Expense

In September 2003, the Company repaid all of its outstanding senior and subordinated debt. The Company had no interest expense in the nine months ended September 30, 2004, as compared to $675,000 of interest expense for the nine months ended September 30, 2003.

Equity in Income of Joint Venture

In September 2003, the Company sold its entire ownership interest in SI/BAKER, INC. During the nine months ended September 30, 2003, equity in income of the SI/BAKER joint venture was $256,000.

Gain on Sale of SI/BAKER Joint Venture

In September 2003, the Company sold its entire ownership interest in SI/BAKER, INC. The sale resulted in a gain of $4,919,000 in the third quarter of 2003.

Gain on Disposition of Property, Plant and Equipment

The gain on the disposition of property, plant and equipment of $1,361,000 for the nine months ended September 30, 2003 was primarily attributable to the sale-leaseback of the Company's Easton, Pennsylvania facility in February 2003. The sale-leaseback resulted in a total gain of $2,189,000, of which $1,363,000 was recorded in 2003. The remaining gain of $826,000 was deferred and is being recognized as a reduction in rent expense over the five-year term of the lease.

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

(a) Results of Operations -- Nine Months Ended September 30, 2004 Compared to the Nine Months Ended September 30, 2003 (Continued)

Other Income, Net

In September 2003, the Company sold its entire ownership interest in SI/BAKER, INC. The unfavorable variance of $219,000 in other income, net for the nine months ended September 30, 2004 as compared to the nine months ended September 30, 2003 was primarily attributable to revenue-based royalty income from the Company's SI/BAKER joint venture recognized during the first nine months of 2003.

Income Tax Expense

The Company recognized income tax expense of $632,000 during the nine months ended September 30, 2004 compared to income tax expense of $2,545,000 during the nine months ended September 30, 2003. Income tax expense was generally recorded at statutory federal and state tax rates.

(b) Results of Operations - Three Months Ended September 30, 2004 Compared to the Three Months Ended September 30, 2003

Earnings Summary

The Company had net earnings of $465,000 (or $0.11 basic earnings per share) for the three months ended September 30, 2004, compared to net earnings of $2,412,000 (or $0.56 basic earnings per share) for the three months ended September 30, 2003. The decrease in net earnings was primarily due to the prior year comparable period containing:

- a pre-tax gain on the sale of the Company's ownership interest in the SI/BAKER joint venture of $4,919,000; and
- royalty income from the Company's former SI/BAKER joint venture of $58,000.

Partially offsetting the above decrease in net earnings for the three months ended September 30, 2004 was:

- a reduction of $306,000 in interest expense as a result of the elimination of the Company's senior and subordinated debt in September 2003;
- higher revenues and gross profit of $2,012,000 and $782,000, respectively, as described below; and
- lower selling, general and administrative expenses by $764,000 as described below.

With the exception of the following Statement of Operations captions, changes in the third quarter of 2004 compared to the prior year were consistent with those previously noted above for the nine-month period.

Net Sales and Gross Profit on Sales

	2004	2003
Net sales	$10,754,000	8,742,000
Cost of sales	7,738,000	6,508,000
Gross profit on sales	$ 3,016,000	2,234,000
Gross profit as a percentage of sales	28.0%	25.6%

The net sales increase was primarily attributable to an increase in Ermanco branded sales of $1,710,000 and an increase of $302,000 in SI Systems branded sales. Based on contract completion requirements, the increase in sales across both brands was primarily attributable to a larger backlog of orders entering the third quarter of 2004 when compared to the backlog of orders entering the third quarter of 2003.

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

(b) Results of Operations - Three Months Ended September 30, 2004 Compared to the Three Months Ended September 30, 2003 (Continued)

Net Sales and Gross Profit on Sales (Continued)

Gross profit, as a percentage of sales, for the three months ended September 30, 2004 was favorably impacted by approximately 2.2% due to the favorable performance on several contracts initiated in prior periods that were completed during the third quarter of 2004 and product mix.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of $2,228,000 were lower by $764,000 for the three months ended September 30, 2004 than for the three months ended September 30, 2003. The decrease was attributable to the prior year comparable period being impacted by the accrual of $1,020,000 associated with potential defense costs to defend charges asserted against the Company by a competitor relating to the Company's intellectual property that was settled in 2004. Partially offsetting this decrease was the addition of resources aimed at expanding the customer base and an increase in salaries and fringe benefits totaling $94,000, and an increase in consulting and marketing expenses primarily associated with product promotion and marketing research totaling $114,000.

Liquidity and Capital Resources

The Company's cash and cash equivalents decreased to $3,733,000 at

September 30, 2004 from $5,591,000 at December 31, 2003. The decrease resulted primarily from:

- o cash used by operating activities totaling $1,502,000;
- o purchases of capital equipment of $213,000; and
- o repurchase and retirement of common stock of $181,000.

Cash used by operating activities of $1,502,000 during the nine months ended September 30, 2004 as compared to cash provided by operating activities of $1,812,000 during the nine months ended September 30, 2003 decreased primarily due to the payment of settlement and legal costs of $1,197,000 associated with an action against the Company by a competitor relating to the Company's intellectual property. Also contributing to cash provided by operating activities during the nine months ended September 30, 2003 was the receipt of a federal income tax refund of $1,093,000 and the receipt of a $1,000,000 cash dividend from the SI/BAKER joint venture.

In 2003, the Company repaid all of its outstanding term debt and subordinated debt.

The Company's line of credit facility may not exceed $5,000,000, $4,800,000 is available, and is to be used primarily for working capital purposes. The line of credit facility contains various non-financial covenants and is secured by all accounts receivables and inventory. As of September 30, 2004, the Company did not have any borrowings under the line of credit facility, and the line of credit facility expires effective June 30, 2005.

The Company anticipates that its financial resources, consisting of cash generated from operations and its line of credit, will be adequate to satisfy its future cash requirements through the next year. Sales volume, as well as cash liquidity, may experience fluctuations due to the unpredictability of future contract sales and the dependence upon a limited number of large contracts with a limited number of customers.

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

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

Contractual Obligations

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 $33,283 through September 30, 2004. Thereafter, monthly rentals are $29,310 (with annual increases of 2.5%). The terms of the lease require the payment by Ermanco of all taxes, insurance, and other ownership related costs of the property. The lease, as amended on April 1, 2004, expires on September 30, 2008.

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 for five years. The leasing agreement requires fixed monthly rentals of $17,703 (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 office equipment, computer equipment, and software under various operating leases with terms extending through September 2007.

Future contractual obligations and commercial commitments at September 30, 2004 as noted above are as follows:

	Payments Due by Period					
	Total	2004	2005	2006	2007	2008
Contractual obligations:						
Operating leases........	$ 2,318,000	168,000	636,000	590,000	606,000	318,000
Total.........	$ 2,318,000	168,000	636,000	590,000	606,000	318,000

	Amount of Commitment Expiration Per Period					
	Total Amounts Committed	2004	2005	2006	2007	2008
Other commercial commitments:						
Letters of credit........	$200,000	-	200,000	-	-	-
Line of credit........	-	-	-	-	-	-

Off-Balance Sheet Arrangements

As of September 30, 2004, the Company had no off-balance sheet arrangements in the nature of guarantee contracts, retained or contingent interests in assets transferred to unconsolidated entities (or similar arrangements serving as credit, liquidity, or market risk support to unconsolidated entities for any such assets), or obligations (including contingent obligations) arising out of variable interests in unconsolidated entities providing financing, liquidity, market risk, or credit risk support to the Company, or that engage in leasing, hedging, or research and development services with the Company.

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

Recently Issued Accounting Pronouncements

The adoption of SFAS No. 132 (revised) did not have a material impacton the Company's financial statements.

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 earnings, liquidity, financial condition, review of strategic alternatives, and other 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 factors over which the Company has no control, including the strength of domestic and foreign economies, sales growth, competition, and certain costs increases; or (3) if the factors on which the Company's conclusions are based do not conform to the Company's expectations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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 September 30, 2004. 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) Change in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation of such controls 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

In July 2003, a competitor filed an action against the Company in the United States District Court for the District of New Jersey alleging that certain of the Company's products infringed patents held by the competitor and also asserting claims for breach of contract, unjust enrichment, unfair competition, tortious interference with prospective economic advantage, and violation of New Jersey's consumer fraud act as a result of alleged improper use of the competitor's trade secrets, technology, and other proprietary information. Based on these allegations, the competitor was seeking monetary damages and injunctive relief against the Company.

In February 2004, a settlement was reached between the Company and the competitor. Under the settlement, the competitor dismissed the action and agreed that the Company's products involved in the litigation are immune from suit for infringement of any of the competitor's intellectual property rights. In exchange, Paragon agreed to dismiss its counterclaims and paid the competitor $1,125,000.

The Company is involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table represents the periodic repurchases of equity securities made by the Company during the three months ended September 30, 2004:

	Total Number	Average Price Paid Per Share (Including	Total Number of Shares Repurchased as Part of a Publicly	Appropriate Dollar Value of Shares Purchased	Appropri Dollar Va of Shar That May Be Purcha

Fiscal Period	of Shares Repurchased	Brokerage Commissions)	Announced Program	Under the Program	Under t Progra
7/1/04 - 7/31/04	-	$ -	-	$ -	$
8/1/04 - 8/31/04	-	$ -	-	$ -	$ 1,000,
9/1/04 - 9/30/04	19,000	$ 9.55	19,000	$ 181,424	$ 818,

In August 2004, the Company's Board of Directors approved a program to repurchase up to $1,000,000 of its outstanding common stock. As of September 30, 2004, the Company had repurchased 19,000 shares of common stock at a weighted average cost, including brokerage commissions, of $9.55 per share. Cash expenditures for the stock repurchases approximated $181,424. As of September 30, 2004, approximately $818,576 remained available for repurchases under the stock repurchase program. Based on market conditions and other factors, additional repurchases may be made from time to time, in compliance with SEC regulations, in the open market or through privately negotiated transactions at the discretion of the Company. There is no expiration date with regards to the stock repurchase program.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

Exhibits:

10.28 Loan Agreement related to the Line of Credit entered into August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, Wachovia Bank, National Association (filed herewith).

10.29 Promissory Note related to the Line of Credit Loan Agreement entered into August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (filed herewith).

10.30 Security Agreement related to the Line of Credit dated August 6, 2004 by and between Paragon Technologies, Inc., Ermanco

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

SIGNATURES

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/ Leonard S. Yurkovic

Leonard S. Yurkovic
President & CEO

/s/ Ronald J. Semanick

Ronald J. Semanick
Chief Financial Officer

Dated: November 12, 2004

EXHIBIT INDEX

Exhibits

10.28	Loan Agreement related to the Line of Credit entered into August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, Wachovia Bank, National Association (filed herewith).
10.29	Promissory Note related to the Line of Credit Loan Agreement entered into August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, and Wachovia Bank, National Association (filed herewith).
10.30	Security Agreement related to the Line of Credit dated August 6, 2004 by and between Paragon Technologies, Inc., Ermanco Incorporated, 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 Leonard S. Yurkovic, 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 Leonard S. Yurkovic, President and CEO (filed herewith).

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